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### Shifting employment

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(Editor)

# Shifting Employment: undeclared labour in construction

European Institute for  
Construction Labour Research

CLR  
Studies 5

Jan Cremers and Jörn Janssen (Editor)

# Shifting Employment: undeclared labour in construction

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Shifting Employment:  
undeclared labour in construction

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# Contents

Introduction	Jan Cremers, Jörn Janssen	5
--------------	---------------------------	---

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Preparatory Research	Jan Cremers	9
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Definitions used in earlier research	9
General findings about nature, size and effects in earlier research	11
Earlier research on undeclared labour in construction	13
Four basic patterns	15
Measures arising from earlier research	20
References	23

Summary and evaluation of the research	Jan Cremers	25
---	-------------	----

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General background	25
Findings about nature and size	28
Effects of undeclared labour	32
Measures	34
Examples and practices	35
Concluding remarks by the researchers	38

Country Reports	edited by Jan Cremers, Jörn Janssen	41
-----------------	-------------------------------------	----

---

Belgium	42
Czech Republic	55
Denmark	68
Finland	79
France	88

Germany ..... 103

The Netherlands .....114

Poland .....126

Spain .....137

United Kingdom .....148

Appendix

---

Working method .....160

Funding/commissioning of the project .....162

Team and steering group .....163

Tables ..... 164

# Introduction

Jan Cremers, Jörn Janssen

In the autumn of 2002 the European Institute for Construction Labour Research CLR produced a report that gave an account of the industrial relations in the construction sector of six EU applicant states. The selected states were Bulgaria, Estonia, Hungary, Poland, Romania, and the Slovak Republic. The research results were published in May 2003 in a book, *EU Enlargement. Construction Labour Relations as a Pilot*. The research touched upon the phenomenon of undeclared labour. In two paragraphs the coverage rates and forms of remuneration outside legal and collective regulation and the forms of employment, taxation and social security were treated (Clarke et al. 2003). One of the crucial findings was an unregulated labour market characterised by an important grey zone of economic activities:

It is in the very nature of illegal employment that it is unrecorded. It is equally in the profound interest of the actors in industrial relations to overstate their influence. Added to these reservations, estimates of the coverage rates of pay regulations must take into account a huge grey zone of formal coverage and hidden as well as semi-legal, open forms of evasion. As a rule of thumb, collective agreements and legal provisions on pay and working conditions will be adhered to the more the social partners are able to control and enforce them. Under present conditions the process of privatisation and ensuing company fragmentation militates against the formal social-partner organisation inherited from the planned economy.

For different reasons both employers and employees share an interest in avoiding wage-related taxes and social security contributions. Whilst employers are under competitive pressure to keep their wage costs low, employees seek to avoid deductions from their gross wages. Thus the savings through the evasion of taxation and social security contributions are shared between the two, although in what proportion it is

impossible to say. Under the conditions imposed by a rampant recession in construction after 1990, privatisation of production units, and liberalisation of the economy, the legally regulated contract of employment (that is imposing the costs of taxation and social security on the social partners), is being widely replaced by the contract of service in a variety of legal and illegal forms. It transfers the obligation to pay taxes and provide social protection onto the employee in the guise of an independent artisan selling the product of labour rather than labour power. The construction industry with its scattered, short-term workplaces, lends itself to this form of independence in employment.

*In Free Movement of Workers in the EU – Directive 96/71/EC on the posting of workers in the framework of the provision of services; the implementation, practical application and operation*, CLR examined the functioning of the legal form of posting created in 1996 by the European Commission with the introduction of the principles of the so-called posting of workers (Cremers and Donders 2004). Also in that study we briefly touched upon the question of undeclared labour.

Construction workers are traditionally an exceedingly vulnerable group in a highly competitive battle between building firms. A fiercely competitive situation in the construction sector is apparent inter alia from the strong pressure to drive down prices ever lower. A major adverse effect of the competitive pressure is the relative high number of bankruptcies in the sector. The incidence of 'fraud' is also extremely high. All in all, the construction sector is sensitive to social dumping and unfair competition, arising from the special character of the sector.

These minor observations were nevertheless in line with the outcome of several studies that construction belongs to the sectors with the highest incidence of informal work. In an in-depth study financed by the European Commission, *Undeclared work in an enlarged union*, the conclusion was that in most current Member States construction is on top of the list of sectors characterised by informal labour (Renoy et al. 2004).

Various reports (for instance OECD 2000) on undeclared labour recognize that construction is one of the most vulnerable sectors. Research by the European Industrial Relations Observatory on the nature and extent of undeclared work, concludes that a substantial part of construction employment is performed under arrangements that can be regarded as dubious (European Foundation for the improvement of Living and Working Conditions 2005a).

Different European and national initiatives have been formulated to prevent and combat undeclared labour. Nevertheless very little sectoral information is available at European level and no in-depth assessment has been made of the compatibility of the proposed measures with the construction industry. Information on the size and structure of undeclared labour and sectoral research on this topic are sparse. And, as noted by the EFBWW in the working programme for this project, it is not possible to consider 'undeclared work' as simply a homogenous concept. The fact is that, in practice, there are a great many variations.



Against this background CLR welcomed the initiative of the European social partners to study undeclared labour in the construction industry. We were more than willing to take the lead in the research needed.

In their multi-annual working programme EFBWW and FIEC have agreed to use analyses and research as the bases for joint proposals for effectively preventing and combating undeclared labour in the industry. The main purpose of the project was therefore to analyse and evaluate the overall practical implementation, achievements and impact of national and European initiatives to combat undeclared labour in construction. The research had to lead to a qualitative assessment of the wide variety of arrangements used, the impact on the industry and best practices to prevent and combat undeclared labour.

In the *Free Movement* study we had to conclude that there is no uniform answer to the question of who is in charge of control, enforcement, and penalties relating to national regulations (Cremers and Donders 2004). It all depends on the regulatory tradition in the Member States and the relationship between legislation and conventional rules. What is more, arrangements that can be described as dubious or unlawful in one country can be normal in another. As a consequence some forms of undeclared labour are not seen as a problem in countries with, for instance, no sectoral arrangements of an 'erga omnes' character.

Finally, based on previous experience, the risks of misunderstanding in the use of terminology and definitions could be estimated to be very high in this project. To give just one example: although several studies have supported the conclusion that undeclared labour is widespread among workers that have a job in the formal economy, some earlier national research only examines the aspects of illegal migrant workers. It is the explicit aim of the authors to avoid this type of bias.



# Preparatory Research

Jan Cremers

## Definitions used in earlier research

What is at first sight striking is that most of the overall studies available on undeclared labour pinpoint legislative (taxation or social security) aspects. In certain countries however the conventional framework (of collective agreements and joint regulations) is even more important as the reference for undeclared or illegal construction work. In several Western European countries the regulation of the formal economy is not the exclusive task for the national authorities. Europe is rich in social partnership and knows in many countries processes of autonomous collective bargaining and of regulation by sectoral provisions and other joint instruments.

The official definition that is mostly used by the European institutions – “undeclared work can be defined as any paid activities that are lawful as regards their nature but not declared to the public authorities” – is too much focused on the legislative side of the problem – with the public authority as main actor – and leads us away from the conventional side (European Commission 1998).

Both ILO and OECD have always used a broader definition, taking into account “laws, regulations and practice” and “one or more administrative authorities”. The ILO also later came up with “labour not recognised or protected under the legal and regulatory frameworks”.<sup>1</sup> In line with this modification the European Industrial Relations Dictionary adds: “bearing in mind differences in the regulatory system of Member States” (European Foundation 2005b). In the latest publications the European Institutions also complement the earlier definition by adding “taking into account the differences in the regulatory system between Member States” (Renoy et al. 2004).

<sup>1</sup> The European Foundation for the improvement of Living and Working Conditions has given a representative overview of the definitions used by several institutions in a thematic feature *Industrial relations and undeclared work*, EIRO, Dublin, 2005.

There is great diversity in the national definitions used. In the EIRO thematic feature on undeclared work (2005), 20 EU Member States were involved. Six countries defined undeclared labour as an infringement of tax and social security provisions and used the definition “any work not declared to tax and social security authorities”. In two countries there was and is a limitation only to the “tax authorities”. The remaining majority uses broader definitions that are not easy to categorise, with such additional and explanatory remarks as “notably unlawful foreign employment”, “any work performed without an employment contract” and “activity while receiving unemployment benefits”.

Given this diversity it is necessary to undertake research more tailor-made to the construction industry. Undeclared labour arises from non-compliance with legal and conventional regulations in the field of taxation and fiscal law (both income taxes and VAT), social security, labour law, collective and sectoral agreements with a generally binding character. To reiterate, it all depends on the regulatory tradition and the relationship between legislation and conventional rules in the respective Member State. Trust in and the quality of (benefits of) legal and conventional provisions and regulations probably play an important role. Undeclared labour refers to forms of employment that sidestep the norms of regular employment regulations. Its actors are the employer, the employee and the customer and it consists of underreporting economic activities, unreported hours of work or undeclared overtime, official wage pay combined with cash in hand and envelope practices, illegal employment via irregular agencies, bogus self-employment, social security and other benefit fraud, VAT and income tax circumvention.

In the grey zone between regulated and unregulated employment relationships, we find in construction a wide variety of arrangements, typically:

- piece rates, individually agreed with no regulation of working time;
- piece rates, individually agreed, with informal agreements on working time and a minimum time rate;
- day rates, individually agreed, with regulated working time and bonus according to performance;
- monthly rates, individually agreed according to firm specific scales, regulated working time including variably paid holidays, bad weather compensation, travel allowances, sick pay;
- collectively agreed pay and working conditions including taxation and social security contributions as a minimum, topped up by individual arrangements for overtime, performance, etc. paid cash in hand, in kind or other benefits.

This list can be extended and refined by more combinations of arrangements partially or entirely outside legal and collective contract regulation. What each has in common is to be predominantly based on individual arrangement, even if collective agreements and labour law are in force. We have to deal not only with clearly defined day labourers and other forms of casual or atypical labour relations (forms that are in a way archaic if we compare these with regular, direct employment), but also with the so-called ‘bogus’ self-employed and with a complete grey or black zone of the economy.

One other demarcation is necessary. The different shapes of undeclared labour can all be classified under what the OECD categorises as underground or informal production (2002). Underground production is then defined as the deliberate concealment of legal activities to avoid payment of taxes related to profits, social security contributions, minimum wages, safety and other labour standards and/or the fraudulent claim of unemployment benefits. Informal production is about non-registration of employees, unreported income from the production of legal goods and activities – most often on a small scale but still with a market-output.

The third category used by the OECD, illegal production and organised crime, is not part of our research. It is characterised by illegal actions or transactions whereby the product itself is forbidden by law. Of course once a building activity is completed, there may be problems with permits or product liability when undeclared labour is used; this is partly the risk the customer takes. But the construction output as such is a visible and lawful product and illegal buildings can be ignored.

## General findings about nature, size and effects in earlier research

Estimates of the overall size of the informal economy in the EU Member States range from 7% to 16%, with national figures varying from 1.5% or 2% (Austria and UK) to over 20% (Greece). The new Member States from the CEE stay within that range. Other countries like Bulgaria and Romania have a score similar to Greece (Renoy et al. page 106 and 157). Whatever the amount, the relative frequency and features of undeclared labour are crucial factors in developing an effective and pro-active policy. All relevant studies, deploying various methods, indicate that undeclared labour has been on the increase since the early 1990s.

Most overall studies situate the different forms of undeclared labour in labour-intensive industries such as construction, hotels and restaurants, transport, cleaning and (domestic) services, assuming:

- a high share of low-paid and unskilled jobs as a precondition for undeclared work,
- the presence of a significant proportion of small and medium sized companies,
- that the key reason is lower labour costs,
- a relationship with the economic cycle, with recession then leading to more undeclared labour,
- that undeclared labour is mainly carried out by the most vulnerable category of workers, unemployed, people in social benefit schemes, seasonal workers, students, and migrants.

Some researchers present estimates and calculations that contradict the above figures (for instance Schneider 2003). Based on our own experience, we would also question these figures and assumptions:

- Observations from industrial relations experts and even the public debate can be indicators of the presence of undeclared work as a significant topic. It is of course

no great help to exaggerate personal impressions or descriptive analyses. But in Britain, for instance, all observers and actors in British industrial relations will tell you that the low figure given has nothing to do with reality and the same could be the case in other countries. We had therefore to evaluate these figures in the course of our research.

- The assumptions above also need a closer examination. Reliable figures show that the overwhelming majority of undeclared labour (in construction) is carried out by young male citizens. In certain sub sectors of the construction industry, it is not self-evident for a low-paid or unskilled wage earner to move into independent forms of (partly) undeclared labour.<sup>2</sup> It is also recognised for instance that the unemployed lose access to potential customers and to the use of tools and equipment as soon as they are no longer engaged in a regular job.
- Certain types of unreported undeclared labour are simply not considered because they are more or less accepted by society. The majority of undeclared labour consists of a second job after regular working hours or underreporting by employers and employees with formal labour contracts. Several authors refer to the substitution of regular labour market activities and about a shadow economy that is responsive to changes in the formal market (Enste 2003, Schneider 2003).
- Larger companies have perhaps a more regulated personnel policy and a better administration, but what about the chain of contractors in the industries? Does the world of undeclared labour also have its own hierarchy and 'regulation'? And who is on top of the triangle? Is there a tight relationship and social network between people who are active in the shadow economy?
- A final observation is that for political reasons too authors tend to manipulate the few figures and data available. Several of the so-called basic studies on undeclared work resort to only a few calculations from the same unreliably or questionable figures with, as a result, a pleading for deregulation, flexibility or whatever. Even worse is when a lot of media attention is given to reports demonstrating how good or bad the situation is with regard to the 'hidden economy' on the basis of poor statistical evidence, and policy is built on that information.

There is, therefore, a risk of over- or underestimating the shadow economy and the extent of undeclared labour. It is necessary to differentiate the picture and to look at different dimensions. There will always be a lack of precision given the wide range of types of undeclared labour and it is better not to rely on a single-assumption model.

Our desktop research indicated some of the effects of different types of undeclared labour, whether in terms of the socio-economic field, fiscal revenues and national budgets, distortion of labour markets or of competition, undermining of industry wide provisions. The social partners, for instance, share the view that the secondary labour market is a serious threat to safeguarding working conditions and social insurance rights in the regulated, formal labour market. They also agree that undeclared labour undermines the industrial relations system with industry-wide

<sup>2</sup> In an EMCC report *Trends and drivers of change in the European construction sector* it is said that self-employed are or "skilled workers who see an opportunity in using their skills and experience" or "people working under questionable circumstances" (European Foundation, 2005c).

provisions and regulations established for the sake of continuity in the construction sector. Employer organisations declare that undeclared labour has a negative impact on competition and that it distorts the market. Trade unions hold the view that social provisions based on solidarity come under pressure, just as do working conditions and collective agreements. For governments, undeclared labour mainly represents a financial and budgetary problem and a loss of revenue.

Measures enacted have to take into account the different effects of undeclared labour. For instance, advocating an increase in labour market flexibility is not necessarily an efficient means to reduce undeclared work if it creates new possibilities to circumvent joint and industry-wide provisions. The biggest savings in labour costs are probably still when everybody pays! The size of undeclared labour depends to a large extent on the tolerance of the main actors (customers, employers, employees, governments). As long as many forms of undeclared work are considered normal (or justified as unavoidable and/or useful), the share of the so-called shadow economy in the overall market will stay at substantial level. Even worse are situations where the dominant opinion sees suppression of informal activities as a negative incentive for private business.

## Earlier research on undeclared labour in construction

Reliable figures on the size and structure of undeclared work in construction are not available and extremely scarce in earlier studies. Research on the topic has so far not been carried out on a comparable basis. Information from our preparatory research, though not comparable, is summarised in Tables 1 and 2 in the Appendix to provide a first overview of the incidence of undeclared labour. These findings were integrated in a typology (see Scheme 1) to serve as a verification tool for our national experts.

In general terms, participation in undeclared work in the construction sector is dominated by men, often with a regular job, from the 25-45 year age group, and mostly (semi-) skilled. In some countries earlier findings indicated the prominent presence of professionals. Most surveys point to holders of a regular job only being involved in undeclared labour part-time. At the other end of the scale less favourable positions are reported of unemployed, unskilled or illegal workers. In the CEE countries pensioners can also be added to this group because state pensions are often very small. In a few cases researchers indicated a hierarchy in the 'grey' labour market. Those workers that earn decent wages in their legal job also earn well for their illegal work and vice versa. Women are almost everywhere absent and, where they are present, a gender pay gap is to be found in the informal economy, as in the formal sector of the economy, with men earning up to 15% more than women.

Multiple employment, that is the combination of a legal labour relation with partly 'envelope wages' is a widespread practice. The demand for black labour and the typical form of the use of moonlighting has its roots rather in the middle class than in low-income groups. There is often a tight relationship and social networking

Scheme 1: Typology of undeclared construction labour

	Marginal informal	Unofficial enterprises	Official enterprises
Degree of informality	<ul style="list-style-type: none"> <li>• Completely informal or irregular next to a regular job (moonlighting)</li> </ul>	<ul style="list-style-type: none"> <li>• Informal units engaged in the production of goods and/or supply of labour</li> </ul>	<ul style="list-style-type: none"> <li>• Organisation of irregular labour supply in a formal context</li> </ul>
Position on the labour market	<ul style="list-style-type: none"> <li>• Day labourers</li> <li>• Self employed</li> <li>• One man bands</li> <li>• Agencies</li> </ul>	<ul style="list-style-type: none"> <li>• Agencies</li> <li>• Self employed</li> <li>• Gangs or units at low level of organisation</li> </ul>	<ul style="list-style-type: none"> <li>• Specialised subcontractors</li> <li>• Self employed</li> <li>• Gangs or units with certain regulation/organisation</li> <li>• Professionals</li> </ul>
Labour/capital intensity	<ul style="list-style-type: none"> <li>• Labour intensive</li> <li>• Manual labour with basic technology</li> </ul>	<ul style="list-style-type: none"> <li>• Labour intensive</li> <li>• Manual labour with basic technology</li> </ul>	<ul style="list-style-type: none"> <li>• Labour intensive part in a chain of construction work</li> <li>• Site might be highly capital intensive</li> </ul>
Skill level	<ul style="list-style-type: none"> <li>• Basic skills</li> <li>• Basic level of productivity</li> <li>• Hard working</li> </ul>	<ul style="list-style-type: none"> <li>• All-rounder next to unskilled manual workers</li> </ul>	<ul style="list-style-type: none"> <li>• Unskilled labourers next to skills needed for certain labour market segments</li> </ul>
Market segments/customers	<ul style="list-style-type: none"> <li>• Individual private households</li> <li>• Non visible, small jobs by word of mouth</li> </ul>	<ul style="list-style-type: none"> <li>• Private households</li> <li>• Smaller sites undertaken by informal clients for own use</li> </ul>	<ul style="list-style-type: none"> <li>• Individual private households</li> <li>• Sites undertaken by informal <i>and</i> formal clients</li> </ul>
Relationship with the formal market	<ul style="list-style-type: none"> <li>• Niche activity</li> <li>• Often accepted/goodwill</li> </ul>	<ul style="list-style-type: none"> <li>• Obscure or marginal work</li> <li>• Not attractive for the formal market</li> </ul>	<ul style="list-style-type: none"> <li>• Distortion of competition</li> <li>• Provision of cheap labour</li> </ul>
Main form of activity/branches	<ul style="list-style-type: none"> <li>• Repair</li> <li>• Maintenance</li> <li>• Housing</li> </ul>	<ul style="list-style-type: none"> <li>• Sub-sectors with labour shortages</li> <li>• Renovation</li> <li>• Housing</li> </ul>	<ul style="list-style-type: none"> <li>• Sub-sectors with labour shortages</li> <li>• Housing</li> <li>• Labour-only subcontractors</li> </ul>
Autonomy, labour and working conditions	<ul style="list-style-type: none"> <li>• 'Independent' single and casual employment</li> <li>• Long working hours</li> <li>• Dubious safety standards</li> <li>• Non-compliance with collective agreements</li> </ul>	<ul style="list-style-type: none"> <li>• Dependent in the chain of production</li> <li>• Long working hours</li> <li>• Dubious safety standards</li> <li>• Non-compliance with collective agreements</li> </ul>	<ul style="list-style-type: none"> <li>• Dependent in the chain of production</li> <li>• Long working hours</li> <li>• Dubious safety standards</li> <li>• Non or partial compliance with collective agreements</li> </ul>
Shapes of undeclared work	<ul style="list-style-type: none"> <li>• No employment contract nor bookkeeping</li> <li>• 'Bogus' self-employed or own account workers</li> <li>• Underreporting of income</li> <li>• Non-compliance with regulations and provisions</li> </ul>	<ul style="list-style-type: none"> <li>• VAT and tax evasion</li> <li>• Non-registered employment</li> <li>• Illegal foreign work</li> <li>• Cash-in-hand</li> <li>• Social benefit fraud</li> <li>• Non-compliance with regulations and provisions</li> </ul>	<ul style="list-style-type: none"> <li>• Underreporting of output</li> <li>• VAT and tax evasion</li> <li>• Subcontracting into the grey economy</li> <li>• Cash-in-hand</li> <li>• Social (security) fraud</li> <li>• Evasion of legal or conventional standards</li> </ul>



between actors involved in the shadow labour market. Some forms of undeclared work have a long history and are (therefore) tolerated by the main actors as a structural feature of certain segments of the construction market. In most countries the most prominent role for undeclared labour is in construction activities related to renovation, repair and maintenance, with no invoice being given and with VAT evasion. Given the absence of reliable figures and a lack of analyses about the functioning of the shadow economy in construction, it is difficult to gain a clear picture of the real impact of the phenomenon of undeclared work on industrial relations and on the labour market in the construction sector.

Many authors observe that (part of the) undeclared labour in construction is regarded as a normal phenomenon in society. Combined with low tax morality and a wish by the actors involved to economise on costs, there is significant social acceptance of undeclared jobs. Although there is no real dispute about this morality, we can distinguish between two opposing views: authors that identify the source of informality in poverty, and those that identify it with cost-avoidance.

In general it can be said that, in order to reduce costs, several basic standards, for instance in the field of health and safety, are not respected by clients, employers and workers. As a consequence the rate of accidents is extremely high (and mostly hidden). During a Budapest conference organised by the ETUI and EFBWW, participants considered the link between the economic cycle and the increase/decrease in undeclared labour. One conclusion of that debate was that there is no uniform black box mechanism or automatic link between boom/recession and undeclared labour. Assumptions in this field have to be verified in order to further differentiate recommendations concerning the policy needed.<sup>3</sup>

## Four basic patterns

Undeclared labour can be analysed from different perspectives. Most studies examined during the preparatory research use several dichotomies or dimensions to differentiate between or categorise different types of undeclared work. In terms of construction the most promising dimensions for our purposes are:

- the differentiation between activities that result from autonomous and independent (individual) action and from organised dependent undeclared work,
- work that is completely unregistered (as part of the underground economy) and undeclared labour that is part of registered work (but under-registered),
- the role and dynamic between the three main actors (employee, employer and customer),
- the character of the work done: is it additional, small scale or is it substitution for work that belongs to the hard core of the construction business?
- the position of the actors on the labour market and other labour market dynamics.

<sup>3</sup> European seminar on the prevention of undeclared and illegal labour in construction organised by EFBWW and ETUI-REHS, in cooperation with the Hungarian Ministry of Labour, Budapest, 16-19 February 2006

Based on the research four basic patterns can be differentiated for the purpose of analysis. These patterns combine the above-mentioned aspects and can be seen as 'Idealtypen' helpful for our research. The differentiation is based on two dichotomies:

- undeclared activities in an informal or in a formal context,
- undeclared activities by an individual worker or by undertakings.

The four patterns are:

- a. Informal individual, own account.
- b. Moonlighting (irregular next to regular).
- c. Informal undertakings.
- d. Pyramids of subcontracting.

#### a. Informal individual, own account

This type of undeclared labour is based on manual labour with private households as the main customer. The building activities concerned are repair, maintenance and smaller installation. The workers concerned often have a strong network of middle class clientele. Their activities are well known and new customers come in through word of mouth. The relationship between the worker and the client requires elementary trust and mutual goodwill. Often the quality of materials used is poor and in most cases bought by the clients (in do-it-yourself chains). As a consequence, there are afterwards discussions between the individual worker and the clients. The product's liability is only guaranteed on the basis of a gentleman's agreement. In most cases the size of the work is limited and therefore often not attractive for regular contractors. However there is enough work to do.

This informal part of construction is basically undertaken by domestic citizens and 'bogus' self-employed. Payment is cash-in-hand and completely undercover. In the triangle of actors (worker, employer, customer) there is not necessarily an employer involved. If present, this employer has almost the same role as the customer; the day labourer is paid for his non-registered casual labour, has no labour contract and no fixed labour relation with one employer.



Undeclared labour of this type takes different shapes.

For the *individual worker* the undeclared character takes the form of:

- non-reporting income,
- social benefit fraud,
- non-compliance with social security obligations and other statutory standards,
- income tax evasion.

For an *employer involved*, the undeclared character consists of:

- non-reporting of activities,
- tax evasion,
- non-compliance with social security obligations and other statutory standards,
- non-registered employment and/or fraudulent bookkeeping.

For the *customer*, the undeclared aspects are:

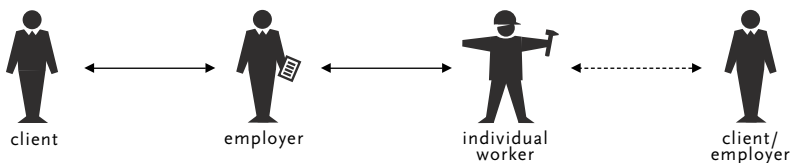
- VAT evasion,
- non-compliance with social security obligations and other statutory standards,
- evasion of client's liabilities.

## b. Moonlighting

The second distinguishable type is to a certain extent a variant of A. Moonlighting takes the shape of a second (irregular) job next to the normal occupation or undeclared parts of work in a normal labour relationship.

The fundamental difference is that the major part of the work done – in the regular job – is part of the formal construction market. The worker has a labour contract (whether written or verbal) with at least one employer. The irregular part of his work is executed next to his ordinary work and is performed either for his own employer or for his own account with another client/employer. In the case of moonlighting for another client/employer the situation is quite similar to type A.

If the undeclared labour is done for the own employer on a normal building site the relationship of mutual trust with the client disappears. In the triangle of actors (worker, employer, customer) another dynamic is present. The relation between the employer and the client becomes the essential part of the transaction and the worker is needed for the labour supply. The worker completely depends for his undeclared labour on the contractual relationship settled between the employer and the customer. The organisation of the undeclared work is still fragmented and on an individual basis. Mutual trust is here needed between the worker and his employer. In cases where the work is done on larger formal sites, the client is perhaps not even aware of the undeclared character of (parts of) the job done.



Undeclared labour of this type takes different shapes depending on the role in the scheme.

For the *individual worker* the undeclared character of this type takes the form of:

- underreporting of income,

- non-compliance with social security obligations and other statutory standards,
- income tax evasion.

For an *employer involved* the undeclared character consists of:

- underreporting of activities,
- tax evasion,
- non-compliance with social security obligations and other statutory standards,
- non-registered employment and/or fraudulent bookkeeping.

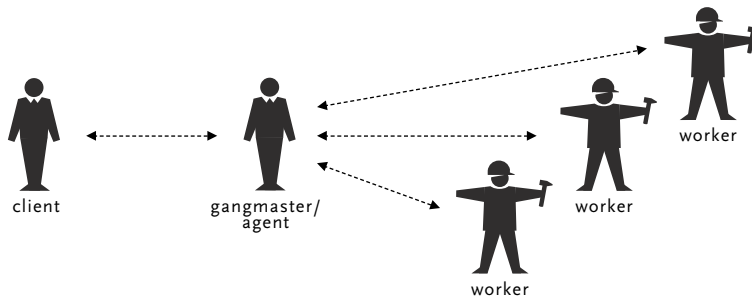
For the *customer* the undeclared aspects are not necessarily known but, in case of abnormally low building prices, there is a risk of:

- VAT evasion,
- non-compliance with social security obligations and other statutory standards.

In cases where the customer is well aware of the undeclared character of the work done, this type of construction work can function as a means of money laundering.

### c. Informal undertakings

The difference between this type and categories A and B is primarily that the labour supply and the whole construction process is organised in a collective way. Groups of undeclared workers work underground via an agency, a gang master or an informal employer. The organisation of the work is via post-box companies, advertising and informal tendering. The agent acts as the go-between and the employer's liability for legal and statutory standards is thus evaded. The product's liability is again only guaranteed by a gentleman's agreement but in this case between the agent or gang master and the client. The size of the work is relatively small (and temporary) and therefore less attractive for regular contractors. The mainly private client has an interest in having the work carried out in an informal way. This informal part of construction is basically undertaken by day labourers and other vulnerable low skilled workers. This is also the type where illegal foreign work comes in. Payment is cash-in-hand and remains undercover. The day labourer is paid for his non-registered casual labour, has no labour contract and no fixed labour relation with one employer. But in practice these units or gangs can function in the hidden economy for quite some time. Recruitment goes via family ties and/or regional or local social networks.



Undeclared work of this type takes different shapes.

For the *individual worker* the undeclared character of this type takes the form of:

- non-reporting of income,
- illegal foreign work,
- non-compliance with social security obligations and other statutory standards,
- income tax evasion and social security fraud.

For an *agent involved* the undeclared character consists of:

- non-reporting of activities,
- evasion of normal employer's obligations (fiscal, social, economic),
- non-compliance with social security obligations and other statutory standards,
- non-registered employment and/or fraudulent bookkeeping.

For the *customer* the undeclared aspects are:

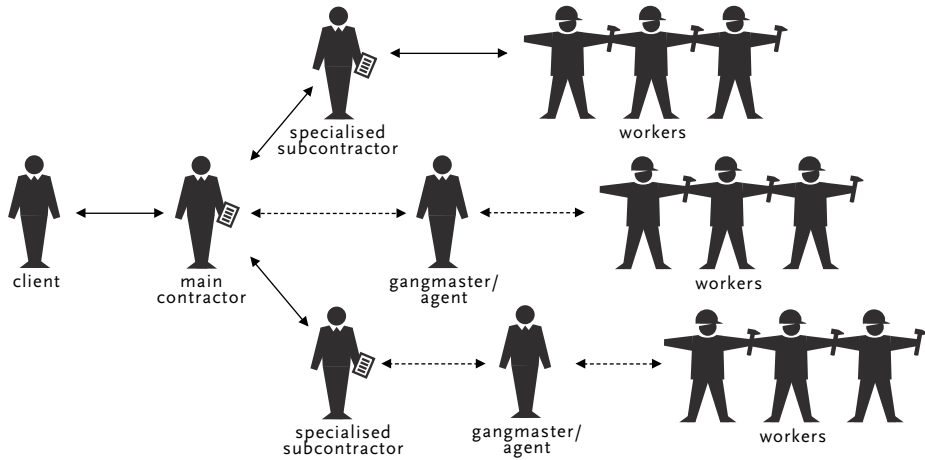
- VAT evasion,
- non-compliance with social security obligations and other statutory standards,
- evasion of client's liabilities,
- sometimes turning illegal money into 'legal' products (in the case of illegal dwellings).

#### d. Pyramids of subcontracting

The difference with type C is that the client is completely out of sight. The construction process takes the shape of a chain of subcontracting and the work is split up into smaller segments and carried out via this chain of subcontracting, starting with the main contractor who 'delegates' part of the work to specialised official subcontractors. A chain can end up in the grey zone, with the result that part of the official site work becomes undeclared.

On top of the pyramid of subcontracting, there are regular and completely legal undertakings and contractors. The lower stratum of the pyramid is an irregular supply of cheap labour via agents or gang masters. Groups of undeclared workers are recruited via post-box companies, advertising and informal networking. Illegal foreign work also appears. The size of the construction site is large, overall coordination weak, and contract compliance difficult to organise. Distortion of the labour market is substantial as the undeclared element may be very attractive for regular contractors. The main contractor has an interest in it because of labour shortages or abnormally low tenders.

The subcontractor/gang master/agent is the go-between for the worker and the main contractor or the specialised subcontractor. Payment is in cash via the agent who acts as the often 'invisible' supplier of cheap labour in this informal labour market of offer and demand. There is a clear hierarchy with skilled labour as foremen and unskilled labour for the basic manual or repetitive jobs.



For the *individual worker* the undeclared character of this type takes the form of:

- non or underreporting of income,
- illegal foreign work,
- non-compliance with social security obligations and other statutory standards,
- wage tax evasion and social security fraud.

For an *agent/subcontractor involved* the undeclared character consists of:

- non or underreporting of activities,
- evasion of normal employer's obligations (fiscal, social, economic),
- non-compliance with social security obligations and other statutory standards,
- non-registered employment and/or fraudulent bookkeeping.

For the *main contractor/customer* the undeclared aspects are:

- distortion of procurement, fake competition,
- underreporting of output,
- evasion of social security obligations and other conventional or statutory standards,
- evasion of chain liabilities.

## Measures arising from earlier research

Various European and national initiatives have been formulated to prevent and combat undeclared labour. The item has been on the EU agenda since the early 1990s. In its *Resolution on undeclared work* (2003) the EU Council called on Member States to cooperate on the issue. The *2004 EU employment guidelines* included recommendations to transform undeclared labour into regular employment. In the 2003 Resolution the Council invited social partners, including the social partners in the different industrial sectors at European and national level, to become active and to promote the declaration of informal activities (Council of the European Union 2003).

EU policy distinguishes between integration (positive incentives and simplification of business environment) and enforcement (application of sanctions and actions to eliminate undeclared work). A further, but less prominent approach is the implementation of awareness-raising campaigns.

At national level it is also possible to distinguish between three different approaches.

1. *Integrative*: involving legalisation, regulation or integration of undeclared labour into formal work. Several Member states have developed policies that could lead to a transfer of certain types of undeclared labour into the official labour market.
2. *Enforcement*: that is enforcement of existing laws and regulations and improvement of control and sanctions.
3. *Promotional*: in some countries awareness-raising campaigns focus on the positive effects of regular declared work and not just on the devastating negative effects for the public budget.

The *integrative* approach is often based on the idea that undeclared labour is a lasting part of the market economy and that the only way to get rid of it is to simplify the business environment. Undeclared labour will then come to the surface and become part of the formal economy. Another fundamental aspect of this approach is the idea that it is necessary to promote the added value of provisions based on taxation and social contributions (value for money). The shape of this approach differs from country to country:

- the removal of (administrative) disincentives and simplification of procedures,
- the plea for an exemptive policy for small and medium sized companies,
- credit facilities and other financial support for starters and self-employed,
- positive incentives for employees in the tax and benefit system,
- liberalisation and flexibility of the labour market,
- reduction of non wage costs and/or social security costs,
- reduction of VAT,
- methods to improve the institutional framework in which employees and undertakings operate.

In a negative sense this approach can lead to pressure on collective agreements and other generally binding, paritarian or industry-wide provisions.

The *enforcement* approach has developed in such a way that most actors are nowadays of the general opinion that it is not the time and moment to come up with new severe penalties or more legislation (with certain exceptions as we observed during our national research). The main focus is on:

- enforcement of existing laws and conventions and improvement of control,
- more staff and resources for the labour inspectorate and other authorities or institutions involved,
- higher efficiency in the penal procedures, sanctioning of all actors involved,
- blacklisting of contractors and/or customers,
- internal discipline (including ban) in the social partner organisations,
- job cards or other employee registration methods,

- deduction of tax and social security contributions,
- other methods linked to liability in the chain (main contractor and/or client oriented),
- improvements in the coordination and cooperation between the actors or institutions concerned.

The third approach, which is to an extent related to the integrative approach, we have termed the *promotional* approach. In countries with a regulated sector policy, it is certainly possible to promote the added value of joint or industry-wide provisions. The way forward is to demonstrate the benefits of declared labour for the industry and the employee:

- an improvement in working conditions makes regular work more attractive,
- joint provisions are necessary/essential for the continuity, job security and the development of skills,
- campaigns that plead for decent and justifiable customer behaviour,
- tailor-made collective bargaining, codes of conduct and modern personnel policy can lead to labour relations that can compete with undeclared labour,
- other instruments are, for instance, the inclusion of social clauses in procurement procedures, the development of certification systems,
- interesting experiences related to formal income status are referred to by some authors. Informality can hinder the use of state and private sector services: "In countries where such services exist, for example, credit services by state-owned or private banks (...) training of employees and managers, etc, entrepreneurs may well choose to be formal, even if regulations are many and taxes are high".<sup>4</sup>

It must be clear that these three approaches can be contradictory. To give just one example: improving facilities for the self-employed can stimulate developments that lead to a greater fragmentation of the industry with in the end less registration.

Member States have first and foremost concentrated on the first two approaches. Important for construction has been the European and national debate about VAT reduction and the need to take away administrative disincentives. Several enforcement strategies have been developed, such as the introduction of blacklisting in public procurement, job cards on site and more staffing for labour inspectorates. Liability in the chain of subcontracting has also been under discussion. Other instruments are, for instance, the inclusion of social clauses in procurement procedures, the development of certification systems and the promotion of vocational training provision. These arrangements can strengthen the functioning of the legal labour market. In countries with a regulated sector policy it is certainly possible to promote the added value of joint or industry-wide provisions based on taxation and social contributions.

<sup>4</sup> *Going informal: Benefits and Costs*, Simeon Djankov in: *The informal economy in the EU accession countries*, Belev, 2003, page 63.



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# Summary and evaluation of the research

Jan Cremers

## General background

Undeclared labour in construction is a phenomenon that always figures prominently in studies dedicated to the illegal part of the labour market. The reasoning is often obvious: construction is labour intensive; sites are mostly dispersed, small scale and temporary; part of the market (private dwellings, maintenance, repair) is difficult to trace and the work is over before you know it. Combined with a bad image almost everywhere in Europe, the risk of exaggeration is omnipresent: construction characterised as a sector for free riders and regulation as outdated. This caricature is neither good for the industry nor for the people that try to earn a decent living with construction work.

Research on the nature and size of undeclared labour and on what the industry can do about it is therefore of utmost importance. Its 'potential' outcome is not only basic material for both sides of the industry in their talks and social dialogue. Given the fact that trends and the structure of undeclared labour in construction are partly the result of socio-economic processes in the internal market of the nowadays 25 Member States, the findings of this study also have an impact on the political debate in Europe concerning (de)regulation, social security and social protection, corporate social responsibility, labour migration and the free movement of workers and services.

In the relatively well-regulated Western European markets the basic form of undeclared labour has consisted for decades of more or less structural moonlighting. This is a basic form that has been generally accepted by customers and (part of) the industry, with construction workers taking advantage of their skills to work besides their regular job. This undeclared construction activity was limited to repair, renovation and maintenance for individual households, painting and finishing work in private dwellings and under-registered own account work. Individual workers

(working undeclared besides a regular job) or self-employed (registering only part of their production), on the one hand, and private customers on the other were the main actors in this section of the construction market. The work undertaken is often not attractive for construction companies because of its small size and potential turnover. Overall this undeclared work has therefore acquired a lot of societal acceptance.

In a period of construction boom, with a serious revival in the business cycle, labour shortages have been temporarily covered by illegal or semi-legal gangs of cheap labour (coming from all over the world). With short-term local or site-related measures (by the labour inspectorate, public opinion, political pressure or trade union action) extreme situations of exploitation have been dismantled or kept within certain limits. As a whole, national measures to keep the scale of undeclared labour under control were successful enough to keep everyone satisfied.

As the internal market was introduced and free movement became the guiding principle in the business environment, two fundamental developments in recent decades have changed this landscape:

- the introduction of management contracting, leading to extensive subcontracting,
- the introduction of easier access to the status of self-employment.

It can be in the interest of the industry to develop a division of labour (between main contractor and specialised subcontractors) and the bona fide self-employed have always played a role in certain niches. But both developments have had (unintended) side-effects with, as a possible consequence, a bypass that leads to circumvention of tax, social security and labour regulations and therefore contributes to the growth of undeclared labour.

Since the beginning of the 1990s the size of direct labour has shrunk. On larger sites (in civil engineering, infrastructure, utilities, and new housing developments) the trend has been for less direct employment on the part of the main contractor. A relatively small and specialised staff is now responsible for procurement and management on site; in the execution of work a chain of specialised contractors is engaged. Social responsibility on site, in some countries safeguarded by liability regulations, can no longer be guaranteed if national regulation is not free-market proof. Other national measures no longer work adequately. The supply of cheap, unskilled labour has become an integral part of lower level subcontracting. Vulnerable and fraudulent labour-only subcontracting is nowadays seen as a permanent feature of the industry. The introduction of the free movement of labour and services and the EU-enlargement have created the environment for dubious trafficking of cheap (foreign) labour. The fact that several EU countries still have restrictions with regard to the entrance of their labour market has only exacerbated the risk of a drive into the illegal, undeclared part of the market.

The propaganda concerning simplification of the business environment has had serious side-effects in recent years. What was introduced in the UK under the Thatcher-government as a new status for the self-employed, has become a simple bypass to enter the market without complying with collective agreements or employment status requirements. The growth of 'bogus' self-employment is no longer a typical British phenomenon. However, as long as the share of construction work in

Western Europe for 'own account' workers was restricted to traditional moonlighting, the introduction of 'bogus' practices of self-employment lead mainly to substitution among the different domestic actors. Here again the introduction of the free movement principles has caused a change. A growing number of foreign self-employed (recognised as such in that status according to the home country regulatory frame) is entering the European market and is substituting the private, domestic part of undeclared labour. The Polish government for instance has promoted the status of becoming self-employed because this creates the possibility to circumvent labour market restrictions in some of the 'old' Member States.

In the 'new' Member States we have seen a complete fragmentation of the construction industry with no industry-wide provisions, weak industrial relations and poor regulation.<sup>5</sup> In such a deregulated market, labour-only practices are the standard: both for the modelling of the home industry and as a key to the restrictive Western European market. The question is whether it is possible to reverse this development. We can expect that the exploitation of workers from the new Member States through bogus agencies is of a temporary nature. Once developments in the home country improve, workers will opt for legal status. But, in the meantime, the border has shifted further to the East (Belarus, Ukraine) and there are no regulations to underpin the fragile labour relations in the CEE-states. An industry cannot be built on self-employment and/or casual labour.

The Member States welcomed the introduction of the free movement principles without a clear stand on the flanking social policy needed. From the very beginning these principles contained serious contradictions: under which rules is work carried out in another Member State and where is the borderline between the free movement of workers and the free provision of services? Unconditional approval of the host country principle in the case of the posting of workers was to begin with missing; later on, the European Posted Workers Directive did not lead to better cooperation between the national authorities involved because of poor national implementation. National solutions against the transfer of cheap labour failed and created new dumping practices (bogus self-employed and illegal trafficking by questionable labour brokers). All this begs for a pro-active policy by the industry itself.

Two of the fundamental freedoms of the internal market (of workers and of services) stand almost in a hierarchical relationship as a result of an ECJ ruling.<sup>6</sup> This has had an impact on the situation on construction sites, both in the case of domestic citizens appearing on site with different employment statuses and in the case of foreign labour.

<sup>5</sup> *EU-Enlargement*, Linda Clarke, Jan Cremers, Jörn Janssen, CLR-Studies 1, The Hague, 2004.

<sup>6</sup> EU law on the free provision of services interfered with the legislation related to the free movement of workers. At the start of the European Community the general view was that the *provision of services* involved specialised workers temporarily needed to install a machine or to guarantee a cross border service to a new plant. Specialised, technical and managerial key personnel could go abroad to provide this assistance. Workers not belonging to these key personnel used to be covered by the principle of the free movement of workers. The situation changed after the *Rush Portuguesa* case; since that ruling construction workers temporarily posted abroad for a fixed temporary duration were also seen as part of a provision of services by their employer. Fortunately the ECJ also stated in this case that Community law does not preclude Member States from extending their legislation or collective labour agreements to any person who is employed, even temporarily, within their territory.

The question now is when is a contract for (the provision of) services in reality a contract of service (a labour relationship)? With the simplification of the entrance into business as self-employed (first in Britain and then, as part of the EU guidelines, all over Europe) in particular opportunities have been created to work with operatives on site under regular employment contracts and with self-employed doing precisely the same work. Nowadays it is possible (and even promoted by some governments) that a person turns up on a building site and presents himself as a self-employed bricklayer or carpenter. And what is more, labour brokers are offering their help in hiring the self-employed to work on site. Whether this is a free choice or not, in most cases these workers are in reality employees. This has created on a European scale the possibility to start with ‘contracts for services’ organised by labour-only subcontractors. Herewith we are far from the original starting point that the transnational provision of services is carried out by key personnel for a short period of time.

## Findings about nature and size

During our research we made several remarkable observations. First of all, we were confronted with the fact that, perhaps because of the actual political climate, in a lot of the resources consulted there is a selective perception of who the main actors are. The registered unemployed, for instance (with as a consequence social benefit fraud), are not prominently represented although they are the main target group in the majority of national measures developed. We found enough evidence to conclude that in most countries:

- the highest occurrence of undeclared labour relates to work carried out by workers next to their regular job (temporary irregular moonlighting, under-registered, for their employer or as handyman on their own account).
- the status of self-employment is abused, with bogus practices by national citizens as well as foreign ‘independent’ workers entering the market through labour-only subcontracting. As far as work is registered, this is limited to the minimum necessary to comply with regulatory obligations; the rest is not declared.
- dubious agencies and labour traffickers supplying cheap illegal labour mainly from abroad have returned. Accommodation and food is often provided by the agency (sometimes with deductions that would do justice to ‘Waldorf’ treatment). The position of the workers is vulnerable in many aspects (dangerous work, entirely in the hands of the trafficker, language problems). But “illegals never complain and work hard” and only little “persuasion” is needed because of their illegal status.

The opening up of the borders after enlargement has in some countries created a new type of substitution on the undeclared labour market. Self-employed workers from CEE countries nowadays offer their services for domestic repair and maintenance and for private households through advertising and word-by-mouth. They find a way out of the vulnerable category and have become a serious competitor to the traditional undeclared handyman.

Extreme emphasis on (abnormal) low prices creates great pressure in the chain of subcontracting. Social risks are then repudiated and shifted to uncontrolled subcontractors or agencies. Some of our experts consulted referred to plain exploitation and organised crime, especially in the eastern border regions of the CEE countries. Contradictions such as growth in construction output at the same time as direct labour is falling are clear indicators of a parallel market. The source of undeclared labour can be identified on the one hand in poverty: informal activities are about survival, subsistence or creating a basic economic perspective. This is especially the case for the most vulnerable group of actors. On the other hand, undeclared labour can be identified with cost-avoidance, which means making more profits or obtaining benefits and earnings without complying with laws and obligations. Based on our research we conclude that the second source is (still) more important in the European construction industry.

The nature of undeclared labour can be described as non- or under-registered work. Although completely reliable facts and figures are not available, there is evidence that the share of undeclared labour in construction is substantial. Some of our findings are in line with the outcome of earlier research. The actors are first of all young male workers (aged between 25 and 45 years), with regular jobs (or regular self-employment) besides undeclared labour. The work they do is of a part-time and temporary nature (moonlighting) and because it is carried out next to their normal job it becomes almost semi-legal. Payment is cash-in-hand, added to a regular wage. There is an upward mobility going on in this segment; the domestic self-employed have nowadays to compete more and more with the foreign self-employed. With a few exceptions (Czech Republic, Poland, the Mediterranean area), the general picture is that unemployed or economically inactive persons are not prominently present in the undeclared construction labour sector. The unemployed lose access to potential customers very quickly and do not have the profit of borrowing equipment or tools from their regular employer.

Those that depend on full time undeclared construction labour (foreign, illegal workers or asylum seekers) belong to the least protected categories on the construction labour market. They are more than willing to work hard and to work long hours. Their aim is to earn a lot over a bearable and limited period in anticipation of better days. Except for periods of extreme recession and slump, domestic citizens are no longer present in this part of the market. The majority of these workers come from outside the EU. The gang master or agency is the (only) link to the outside world. The relationship between the agencies offering the job and the workers is anything but a free agreement and the employment status is peripheral and poorly paid. This type of hiring in and out has grown since enlargement. Once there is a perspective for workers that have entered through this channel for better and more stable working conditions elsewhere, they will leave the sector. In this respect construction often functions as the entry industry.

In the national reports we can find indications of the most affected branches and building activities:

- Moonlighting and bogus self-employment are prominent in repair, renovation and maintenance.

- Bogus self-employment, as part of labour-only subcontracting, is also a way to circumvent contractual obligations on larger sites.
- Repetitive, dirty, dangerous work (such as ground works, site preparation, demolition, form work, roofing) is often the lowest stratum in the chain of subcontracting and therefore wide open for undeclared practices.

At the start of our research we were confronted with the fact that few reliable figures on undeclared labour in construction were available from earlier studies. During the preparatory research we produced an overview based on earlier findings (Table 1 and 2). These annexes contain figures and qualitative findings that are difficult to compare because of different calculation methods and divergent national statistics. We did not intend to enter a statistical dispute and the exact calculation was of secondary importance. Several methods used in our research make it nevertheless possible to estimate the size and scale of undeclared labour in construction, both as a share of construction output and in terms of labour volume. A certain dynamic is therefore discernible, based on new figures and estimates produced by the national experts involved in our project. This information is summarised in Scheme 2.

Based on these findings we may infer that:

- The share of undeclared labour in construction output and employment is much higher in all countries than the average share of undeclared labour in GDP or overall employment. The substantially higher scores for construction with respect to undeclared activities are not related to whether a country has a relatively low or high percentage of undeclared labour as a share of GDP and overall employment.
- The overall picture in construction is not that of an unambiguous increase or decrease of undeclared activities. The development of the main types of undeclared labour analysed differs from country to country.
- All in all, the presence and share of undeclared labour executed by a hard core of regular (salaried or self-employed) workers (next to their normal job or occupation) seems to be a lasting phenomenon everywhere in Europe. This part of undeclared activity is not particularly rising or decreasing. It is difficult to tackle, difficult to trace and control ('disturbance of domestic peace') and difficult to prevent.
- The share of undeclared labour originating in bogus self-employed practices is increasing especially in those regulated 'old' Member States that have restricted entry to their markets. In the non-regulated and often fragmented markets of the new Member States (next to the UK) this practice is particularly present as the normal employment status. This type of undeclared labour is also difficult to tackle: control is complicated and controversial because of the loopholes in the legislative framework for self-employment and the provision of services across Europe.
- The share of (illegal) hiring in and out of undeclared labour has increased since the opening up of the markets in Europe. In countries coming out of building recession and confronted with actual or future labour shortages, the door is wide open for dubious labour brokers. National regulation is circumvented by an appeal to the right of free provision of services. Poor legislation and/or the absence of a strong collective bargaining tradition subsequently result in a completely unpredictable number of undeclared practices.



Scheme 2: Findings of undeclared labour in construction in 11 countries

Country	Number of workers involved	Share of the construction labour population	Share of construction output	Characteristics
Czech Republic	140,000 to 200,000 workers (25% illegal foreign labour)	up to 35%	20%	The proportion of construction in overall undeclared labour is estimated at 50%; undeclared labour is decreasing
Poland	230,000 workers (up to 50% illegal foreign labour)	30-40%	30%	For up to 40% of the workers involved undeclared labour is the basic source of income
Hungary	150,000-200,000 workers			The role of agencies has increased next to bogus self-employment
Belgium			20%	Substitution of the 'classical' types of undeclared labour by self-employed from the new Member States
Denmark		25% of the hours worked		Free provision of services as a way to circumvent restrictions
Finland	20,000 person years	10-12%	11%	Increased activities of agencies and labour-only subcontracting of illegal foreign labour
France			10%	Undeclared labour seems to stabilise or even decrease
Germany	300,000 workers	20%	20%	Decrease in undeclared labour (all industries) is not confirmed in construction
Netherlands	(15-25% of contractors use illegal foreign labour)	17%	15%	Flexibility boom: agencies, temporary, self-employed workers and foreign service providers
Spain	170,000-400,000	7-20%	5%	Regularisation of illegal labour has had effect
United Kingdom	(60% of the construction workforce is self-employed; how many in a bogus situation is not clear)		up to 33% (in repair, renovation and maintenance)	Up to 47% of undeclared labour (all industries) is attributable to construction

- In some countries that have begun to develop new instruments for their construction market (for example Belgium with e-registration) or that show an improvement in the economy as a whole (Czech Republic, France), it looks as if the share of undeclared labour is going down. Some countries that were for decades a focus for economic adventurers because of their geographical position (Germany, Austria, and Italy) or because of their 'free market' image (Great Britain) seem to have a stabilised situation with remarkableousting between the different potential actors. Some countries that have adopted strong labour market restrictions, on the one hand, and have a constant building need on the other (The Netherlands, Denmark) suffer from illegal practices and circumvention that seem to be on the increase. A few countries are in the new crossfire because of their geographical position (Poland, Hungary, Finland, and, to a certain extent, Spain) and will experience permanent pressure on their markets.

## Effects of undeclared labour

Formal or regular labour means compliance with the regulatory sets of obligations and of procedures. Most of the formalities enterprises have to fulfil or to comply with are not by definition related to employment issues (e.g. declaration of existence, permit to establish business, registration with fiscal authorities). One of the difficulties in analysing the effects of undeclared labour is to assess which obligations have to be fulfilled with regard to labour because these obligations may vary from country to country. With the creation of the internal market and the free movement of workers and services, a minefield of juridical complications has been created.

- On the one hand, there are informal business practices that stem from the lack of a formal reference. In other words, there is no obligation to fulfil because practices are simply not covered.
- On the other hand, there is informality that stems from non-compliance with obligations. In this case there is a formal reference but the obligations are not enforced.

The development of undeclared labour in construction since the mid 1980s has been to an important extent a result of this divergence; what is excepted and normal in one country is an infraction of the regulatory frame in another. The effect can be social dumping or undermining of social provisions on the one hand, and distortion of competition based on the violation of labour standards and other mandatory rules on the other.

Based on the research we have come to the conclusion that, next to 'traditional' moonlighting, there is the relatively new appearance of circumvention created by the unclear and controversial division between a contract for (the provision of) services and a contract of service (a labour contract). The construction industry becomes populated with workers that are paid on a self-employed basis but who are for all practical purposes employees. If this goes hand in hand with fraudulent transnational

activities of agencies (that hire in and out), the employment status of the operatives involved can be described as bogus.

In general the determination of an employment status does not seem to be complicated: elements of an employment relationship are, for instance, the fact that the work is done under the organisation, control and direction of another person, with remuneration, performance in person, and no freedom to work for others at the same time. Also the ownership and use of equipment is a reference point.<sup>7</sup> But we must conclude that recent developments in construction have created several possibilities for circumvention of the use of directly employed labour.

The common effect of undeclared labour (whether by domestic handyman or foreign labour) is under-registration. As a consequence the financial basis for social provisions is eroded (next to the lower revenues of the tax authorities). Contract compliance becomes the exception not the rule. A second effect is a downward trend in prices with no relationship to the performance required. A private customer can gain short-term profit, but value for money becomes empty of meaning because of poor quality. On larger sites there is a growing need for supervision. Thirdly the image of the industry is further eroded. The association of undeclared labour with illegal trafficking, exploitation and 'slave-trade' puts construction in the wrong corner. If the short-term agenda dictates the playing field then productivity is in danger. It goes without saying that, with widespread non-compliance, competition is distorted. The increase of casual employment that takes place as a result of deregulatory measures can lead to exploitation of vulnerable groups. Non-contribution to sectoral provisions and funds finally endangers the quality of vocational training, social innovation and continuity. De-skilling can be the result.

It is remarkable that the fight against undeclared labour is still in its infancy. Analysis of the effects, the nature and size are, with some exceptions, sparse and of recent date. Foreign illegal work has brought the phenomenon back onto the agenda. This also complicates assessment of the measures taken. Circumvention created by cross border activities can only be tackled in Europe if there is a common frame of reference:

- It is more than ever necessary to define a uniform employment status. In the informal undeclared economy we find both independent and dependent workers. A policy to reduce undeclared activities has to take into account whether workers are dependent or not. To avoid circumvention a European definition of self-employment is needed.
- An important part of the informal economy is created because Member States see it as a competitive advantage to export labour as a provision of services with as a consequence that labour law or regulations cannot be applied or enforced. As long as there is a lack of case law or jurisprudence in this field, abuse of the principles

<sup>7</sup> In a recent meeting the ILO came up with a *Recommendation concerning the employment relationship* that has broad support: among the indicators are the fact that the work is carried out according to the instructions and under the control of another party, is performed solely or mainly for the benefit of another person, must be carried out personally, is carried out within specific working hours or at a workplace specified or agreed by the party requesting the work, involves the provision of tools, materials and machinery by the party requesting the work. Other indicators are the payment of remuneration and the recognition of other entitlements. 95<sup>th</sup> Session, International Labour Conference, Geneva, 31 May 2006.

of free movement and ‘creative’ solutions for transnational trafficking of labour are difficult to tackle.

- Inadequate implementation of labour law and the development of social security rules that are not proof to transnational circumstances have to be avoided. In the *Free Movement* study we have seen that the implementation of the Posted Workers Directive has been poor. The unintended effect in some countries has been that loopholes have been created for dubious practices.

## Measures

Our preparatory research revealed three types of approaches to measures taken: a. integrative approach, b. enforcement and c. promotional. Following the research in the countries involved in this study, it is possible to come up with a non-exhaustive overview of measures applied. A number of measures taken, whilst sympathetic, have limited impact on the fight against undeclared labour in construction. Some are still in their initial phase so that it is difficult to assess their importance and effectiveness. It is also self-evident that measuring the effect of initiatives is as problematic as the calculation of the size of undeclared labour.

### a. The integrative approach

This approach has two basic forms: either it is focussed on integration of unemployed into the legal market or it is based on simplification of the business environment:

- the *introduction of service cheques*: the unemployed can declare part of their (so far) undeclared labour and enter the official labour market. The customer pays only part of the wages; the state or community pays the rest;
- *abolition of the prohibition (or ban) on the hiring in and out by temporary agencies* in an effort to create more temporary and flexible possibilities for the unemployed;
- *simplifying access to self-employment status*; the idea behind this is that entrepreneurship is opened up to the unemployed;
- opening up of the market for small service providers by *lowering the professional criteria*; the regulation of business is seen as old fashioned and as an act of protectionism;
- *reduction of VAT and/or corporate tax*; on the grounds that this increases all actor's interest in declaring;
- *tax exemptions for private customers*; this is one of the few measures where the customer is the target group;
- development of *new registration systems* with easy access for bona fide contractors; once registered a link with all necessary authorities is established;
- *general amnesty for contractors and workers* who act illegally and do not declare. The aim is to regularise foreign workers in illegal situations (by fixing a period during which employers and workers can formalise their labour relationship without being subject to sanctions).

### b. The enforcement approach

The general opinion in the Member States is that new legislation is neither needed nor effective. The aim should be to inspect, control and verify the existing legislative and regulatory framework. Several methods and instruments have therefore been introduced:

- *identity cards* (Job card or Builders card), a method to facilitate inspection on site and to control compliance with social security and other statutory obligations;
- *linking up of controlling institutions*; different methods have been developed to improve coordination and cooperation between the responsible authorities;
- *more staffing* of labour inspectorates and controlling bodies;
- *higher fines* and other penalties; introduction of social criminal law;
- *liability in the chain* (development or improvement of legislation in this field); this can vary from basic liability for the main contractor to social responsibilities for the customer/client. Application can be broad (tax, labour legislation, social security, labour conditions, health and safety) or narrow (social security, tax);
- *social clauses* in public procurement or obligations to employ direct labour;
- often combined with *blacklisting* (or naming and shaming) of fraudulent undertakings.

### c. The promotional approach

At first glance the promotional approach does not appear widespread, but, if we do not limit ourselves to the often promoted (and important) ‘looking good’ campaigns, a few interesting measures are apparent that can have an effect on the size of undeclared labour:

- the further *development of collective agreements*; although seen as an old-fashioned instrument these agreements have improved the perspective in the industry in some countries;
- the same applies to *the introduction of minimum wages*;
- *direct involvement of the industry in recruitment*; the professional hiring in and out by the industry guarantees declared and legal entrance into construction;
- *codes of conduct* and other types of authorisation;
- *accreditation* or certification based on professional and social standards developed and controlled by the industry (Trustmark and others);
- *transnational cooperation* and inclusion of foreign workers in labour market organisations and in joint provisions set up by both sides of the industry.

## Examples and practices

Most experts have come up with a critical review of the measures actually used. The different country reports provide a clear picture of efforts by the social partners and the authorities to fight undeclared labour.

### a. The integrative measures

Several Member States have experimented with the introduction of service cheques or voucher systems. These pilot projects have not been used so far in construction. In theory, a voucher system has the advantage of bringing undeclared activities to the surface. Decent registration and integration in the formal market thus becomes possible. Based on our research, the possible usefulness of such a system for the construction sector can be seriously doubted. Like many other instruments that have the unemployed as the main target group, this measure does not take into account the main character of undeclared labour in the industry.

Some measures to simplify the business environment (easier access to self-employment status, lowering of professional criteria) may work out positively for bona fide skilled workers with the ambition to start as entrepreneurs. In reality, however, these measures also have a number of unintended negative effects if they result in the abolition of professional standards. The industry needs a system of accreditation or certification to neutralise these side-effects of greater flexibility.

More temporary and flexible possibilities to hire in and out have always been a difficult issue (and a risky business) in construction. It is hard to see how the fight against undeclared labour can be promoted by deregulation of this sensitive aspect of the construction labour market. Most experts have a sceptical evaluation of this instrument if it is set up without any quality control or certification scheme from the side of the industry itself.

There is no hard, coherent evidence that tax reduction leads to a decrease in undeclared labour. This finding is in line with earlier studies. An undertaking with partly non-registered activities (and double bookkeeping) or a regular (salaried or self-employed) worker with undeclared side-activities next to a normal job will not be interested in revealing this. The same is true for illegal agencies on the market, hiring in and out gangs of undeclared labour. Furthermore there is serious concern that tax reduction leads to a race to the bottom. On the other hand, tax reduction can improve the competitive position of bona fide small and medium sized undertakings in certain segments of the construction market. There could be a positive effect as well in the direction of the bogus self-employed, to give a more 'formal' image to the work done. The question is whether this counterbalances the costs of tax reduction.

If the central stimuli for undeclared labour are cost avoidance and labour shortage, a strengthening of the deregulatory approach is at least questionable. Construction is often seen as the entry industry for the labour market. Further deregulation, followed by de-skilling and a decrease in professional standards, increases the serious problem that the industry has (and will have) in the competition for new, qualified workers. Deregulation should therefore pinpoint the removal and simplification of bureaucratic demands and procedures, not the lowering of professional standards or quality licences. Some of the new registration systems developed in Member States give the promise of more transparency on the administrative side of the market. A further streamlining of registration and more coordination between authorities, combined with an obligation for main contractors to work with registered undertakings, build a transparent and consistent frame that is promising in the reduction of dubious labour-only subcontracting.

The general amnesty as applied in Spain has been a success. However, it can hardly be seen as a permanent strategy. What we can learn from it is that an integrative approach towards illegal workers (based on social inclusion and integration in the formal labour market) pays. Illegal work as such is not a goal for the workers involved. Their aim is to be part of the labour market and in the long run to perform their activities in a regular job.

#### b. The enforcement measures

The general opinion that new legislation is neither needed nor effective is shared by most of our experts. Higher penalties and fines imposed are ineffective as long as the chances of being caught are so symbolic that the 'risk can be taken'. There is a clear gap in some countries between a detailed legal framework with resulting sanctions and the real (and perceived) risks of being prosecuted. A straightforward plea for more staffing of the responsible inspection services is by far too simple. What is necessary is a clear commitment to cooperation and coordination of all institutions involved. Some countries have started with broad alliances in the enforcement strategy, including the engagement of the social partners in the measures taken. This is welcomed by most of our experts as a way forward.

The introduction of an identity card for building workers on site is under discussion all over Europe. Implementation is, however, still in its infancy. Combined with a mandatory registration of workers on site, the use of such a card has proven to be a strong instrument for control and verification. The weak aspects of this approach are of course the risk of fraud and the need for watertight registration procedures. If the card has to become an instrument in the verification of data of cross border work and foreign labour, transnational harmonisation is necessary in order to avoid 'protectionist' reproaches. In earlier research we have seen that cooperation between Member States in the case of the posting of workers is almost entirely absent. The issue and registration of the so-called E101-formula, according to Regulation 1408/71, also proved to be open to abuse because of lack of control and verification in both the home and the receiving countries.

Any development of new registration measures has to bear in mind that there are new methods 'invented' to circumvent compliance. Notwithstanding this, working site notification combined with transparent and efficient registration procedures (as considered under a. above) can create important conditions for an effective enforcement strategy. In this respect it is striking that substantial resistance by the industry to on-site identification and notification is still to be found. It seems logical for both sides of the industry to take a stronger role in the preparation and implementation of these measures. A clean record is the best contribution to a better image.

It is doubtful that 'naming and shaming' has more than a symbolic effect. A reverse strategy might be considered more effective in preventing undeclared practices and improving fair competition in construction, involving: respect for social clauses in public procurement, unambiguous backing for liability provisions, and joint standards of social responsibility. Currently such instruments hardly play any role in the countries included in the study.



The organisation of the production process has led to the increasing use of specialised subcontractors. The ensuing division of labour makes sense and can lead to an improvement in quality and know-how, higher productivity and economy in overhead costs. A strategy based on the use of labour-only subcontracting with the aim of fixing reduced prices carries the risk that sooner or later undeclared labour enters. In order to cope with this problematic aspect of a chain of subcontracting, different national systems of liability in the chain have had been tried. Registration of undertakings involved in a chain of subcontracting and a clear legal definition of liability and social responsibility in the chain (including the role of the client) contribute to better awareness of contractors and subcontractors of the social standards to be observed. Systems that include deduction of social security payments and other social obligations guarantee financial backing for these measures.

The increasing focus on foreign labour appears disproportionate. The emphasis given to this type of undeclared labour detracts from the few resources available to inspecting authorities. As a consequence, the other types of undeclared labour (regular next to undeclared and bogus self-employed) escape broad public attention. What is more, the inspections concentrate too much on the last link in a chain that begins with tolerating dubious recruitment. The political situation in Europe does not give grounds for much hope as long as countries regard lack of regulation and control of the industry and hiring in and out by agencies as a competitive advantage for their 'provision of services'. The often 'invisible' go-between is hardly ever detected.

### c. The promotional dimension

Promotional instruments are often seen as the 'soft' alternative for legislation. Social partners and especially trade unions have however serious reservations in this area. The first and also the easiest step because of the loose commitment necessary, is (joint) campaigning with leaflets, information brochures and website portals. Recent campaigns, in for instance Norway, with information packages in the necessary languages have led to the inclusion of foreign workers in the normal employer-employee relationship. Information and instruction meetings dealing with foreign labour, as organised in the Netherlands by the employer's organisation, belong to this category as well. Codes of conduct (for more than publicity and image building) are still rather rare in construction. Certification in the industry is mainly dominated by and concentrated on technical standards. Social accreditation is not practiced on large scale. In some countries first steps towards active involvement in the recruitment of foreign labour, partly because of expected labour shortages, have been taken.

## Concluding remarks by the researchers

A key observation of this study is that national instruments developed to bring undeclared labour to the surface often do not work because of an incorrect analysis of the actors involved. Many instruments have the unemployed as the target group. The



assumption is, for instance, that through service cheques undeclared labour can be brought into the regular market. Service cheques can then be attractive for the unemployed who thus have the possibility to formalise their activity. However, if the main actors in undeclared labour in construction are regular workers or the self-employed who partly do not register their work, one cannot expect them to declare via service cheques.

Simplifying the business environment has had serious side-effects. Even the EU has referred to the promotion of entrepreneurship and the stimulation of self-employment in the same breath as a perspective for the unemployed. The effect is the growth of bogus self-employment. Introduction of an easily accessible status for the self-employed has fragmented the industry in the UK. In some CEE countries the same development is occurring. Simplification of registration combined with the free movement of services has created a new instrument to enter the market with serious risks of distortion of competition and social dumping practices. With no threshold or legal obligation, business registration can be easily made; the question is, however, whether the real work done corresponds to this registration. In several countries registration as self-employed is simply used to circumvent the legal and contractual obligations of direct labour, although – judged objectively – the labour relationship is normal and dependent. But who cares and who controls? Simplification of the hiring in and out and the unconditional abolition of the ban on interim agencies have weakened the possibility for verification and inspection.

Control of compliance is weakly developed. The strongest control and enforcement procedures are still dedicated to tax evasion and circumvention of statutory social security payments. Compliance with other labour legislation, perhaps with the exception of health and safety on site, has much less priority. Labour inspectorates have small staff and few resources. In some countries better cooperation (between labour inspectorate, police, tax and social security authorities) has been introduced and staffing of the controlling institutes improved with significant effects. Poor contract compliance in relation to collective agreements is in general not sanctioned. Even in countries where collective agreements are made generally binding (*'erga omnes'*) they are mostly seen as a private contract with no active role for the state. Paritarian, industry-wide provisions often lack an instrument to enforce compliance. The social partners have made serious efforts to improve this situation.

To summarise our overall findings:

- a. The most common target group for existing measures to fight undeclared labour does not correspond to the main actors in undeclared labour in construction. As a consequence the measures taken have only a minor effect on decreasing the phenomenon of undeclared labour.
- b. Existing national definitions of employment status, of independent workers and of a contract for services are not practical for an effective policy as long as they are formulated and defined only within these national boundaries. Formality implies compliance with labour regulations and social security laws. Differences between the absence of rules and non-compliance with rules, notably between coverage and compliance can no longer be solved within the national territory.

- c. Different categories require different measures. We found three basic types of workers involved in undeclared labour in construction: regular wagedworkers, self-employed workers and non-registered workers (depending on agencies or illegal hiring in and out). Their legal status is different as is their degree of vulnerability. Solutions to the problem of undeclared activities require differentiated treatment and measures.
- d. The relationship between the different actors involved in undeclared labour (customers, employers, workers, institutions for labour supply, public authorities) must be integrated in a regulatory framework that determines the obligations of all actors. It implies liability in the chain of subcontracting, control over the hiring in and out, monitoring the influx of workers. Authorities have to establish methods to guarantee compliance with labour rights and compulsory formalisation of employment relations together with procedures and methods that promote fair competition.
- e. The exercise of collective rights and recognition of the actors. The genuine self-employed must have the possibility to enter into labour market organisations and must have better opportunities to be represented. Trade unions and institutions created by the industry in the interest of workers (training facilities, health and safety, social funds) have to develop a strategy that leads to the integration of workers in vulnerable positions with regard to undeclared labour. Regularisation programmes and campaigns, organised by the authorities and the social partners, have to be considered.
- f. Improvement in overall coordination (between authorities involved) to ensure compliance with legal provisions has direct effect. The labour inspectorate and other inspection services must therefore extend and improve their cooperation and coordination in order to make workers' rights a reality. New administrative mechanisms that can facilitate an effective policy to develop and enforce social protection have to be introduced.

# Country Reports

Jan Cremers, Jörn Janssen (Editors)

# Belgium<sup>8</sup>

## Regulation and institutions

### Taxation

The Code on Income Tax 92 contains provisions on direct tax law, such as personal income tax, corporate tax, legal entities income tax and non-resident income tax. Construction companies are subject to direct taxation under corporate tax law. The main actor involved is the Federal Public Service Finance (FPS) with its inspection services.

### Social security legislation

Basic social security legislation is contained in the law relating to the National Office for Social Security and the law on the general principles of social security. Social security contains seven sectors:

1. old age and widowhood pensions;
2. unemployment;
3. insurance for accidents at work;
4. insurance for occupational diseases;
5. family benefits;
6. sickness and disability insurance;
7. annual holiday.

The social security system is divided into three areas: one for salaried persons, one for the self-employed and another for civil servants of the federal government. For those who are self-employed, there is also social insurance in case of bankruptcy.

<sup>8</sup> The basic country report was written by Filip van Overmeiren, researcher Social Law Unit, Ghent University, Belgium. His report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

Unless determined otherwise by international agreement, salaried persons with a labour contract in the service of an employer or an operational office in Belgium will be subject to the Belgian social security scheme for salaried persons.

The self-employed pay a quarterly social security contribution to the social insurance fund with which they are affiliated. Their contribution is estimated on the self-employed person's net professional labour income in the third calendar year preceding the year during which the contributions were paid.

## Labour legislation

Most relevant labour legislation concerns labour regulation (principally labour organisation) and health and safety in the workplace, and includes:

- a general law (1965) concerning the protection of the wage;
- the implementation (2002) of Directive 96/71/EG concerning the applicable labour legislation in the case of posting of workers;
- labour law (1971) concerning working hours, rest time, night and Sunday work;
- law on the combination of work and well-being (2001) concerning collective reduction of working hours;
- law (1974) ruling public holidays;
- coordinated laws (1971) concerning annual paid holiday periods;
- law (1987) concerning temporary labour, agency work and lending of personnel;
- law (1965) concerning the formulation of labour orders;
- Royal Decree (1978) concerning the keeping of social documents;
- Royal Decree (2002) ruling the immediate declaration of employment (DIMONA, see 'Measures' below), to a large extent removing obligations relating to the keeping of social documents;
- law (1996) concerning health and safety at work, together with related legislation constituting the code on well-being at work.

This legislation has to be viewed alongside the body of generally binding inter-professional agreements negotiated by the National Labour Council and sectoral collective agreements made at the level of the joint committees. The most important collective agreement in construction (agreed on 2nd June 2005 in Joint Committee nr. 124) dealt with wages, premiums and compensations, labour regulation, additional social benefits, trade union delegations and the health and safety of workers.

## Competent institutions

The main actor in the field of labour legislation is the Federal Public Service for Employment, Labour and Social Dialogue with its inspection services. Trade unions and employers' organisations negotiate collective agreements and play an active role in the enforcement of the rules concerned. For additional social benefits for the sector, the Fund for Social Protection (FBZ) is predominant.

Representative trade unions are the General Labour Federation of Belgium (ABVV/FGTB), the Confederation of Christian Trade Unions (ACV/CSC) and the

General Confederation of Liberal Trade Unions of Belgium (CGSLB). The employers' organisations are the Association of Belgian Enterprises (VBO), the Union of Independent Employers (UNIZO) and UCM (an association of small employers). The Confederation of Construction and the Bouwunie are the sectoral employers' organisations.

### Regional institutions

The most important institutions at the regional level are the Administration Work and Social Economy of the Ministry of the Flemish Community, its French-speaking counterpart, the Division de l'Emploi et de la Formation professionnelle Direction générale de l'Economie et de l'Emploi de la Ministère de la Région wallonne, and its equivalent for Brussels-Capital Administration Economy and Work of the Ministry of the Brussels-Capital Region. These institutions are responsible for working permits in their territory and for the recognition of temporary work agencies.

### Public prosecutor and the courts

The most relevant court is the Labour Court, which has jurisdiction over disputes concerning labour contracts and social security, accidents at work and occupational diseases, employers' obligations regarding social security, unemployment, sickness and invalidity, pensions, annual holidays, social assistance and so on. The Labour Court of Appeal hears appeals of decisions made by the Labour Court.

## Nature and features of undeclared labour

### Definition

'Undeclared labour' has no legal or practical definition in Belgium. Different institutions and even staff within these institutions have a range of views on how to define undeclared labour. The law of 6th July 1976 to suppress illicit work of a commercial or craft nature provides a legal definition of illicit work which only refers to the informal individual work for own account. It does not contain measures against other appearances of undeclared labour. Under this law, illicit work is defined as "the work that can be the subject of an occupation related to craftsmanship, commerce or industry and which is carried out by a natural or a legal person not registered in the register for craftspersons or the commercial register, or who is in breach of the legal provisions concerning licenses, insurance obligations or registration with relation to the exercise of a profession, as far as this work has a specific professional character, be it due to its size or technical nature, to its frequency or to the use of certain materials or tools".

A categorisation of different aspects and different forms of undeclared labour, both dating from 1993, is still considered very valuable. Undeclared labour is regarded as:

- activities to circumvent the payment of income tax, VAT or other taxes;
- activities to circumvent the payment of social security contributions;
- activities to circumvent the application of other legislation such as this relating to

- minimum wages, working hours, health and safety at work;
- activities to circumvent other administrative obligations.

A classification of different forms and grades of undeclared labour also dates from 1993:

- traditional undeclared labour in its most pure form: where a worker is not registered in social documents, not declared to social security institutions, and pays no taxes. These workers can be persons receiving social security benefits (social benefit fraud, unemployment, sickness or invalidity, pre-retirement, pension) or not (moonlighting, persons working in shifts while having another undeclared profession, or illegal immigrants). A more subtle form is when the worker is registered and declared to the social security institutions, but no contributions are paid. A third form is the one where activities are declared, but wages, salaries or compensations are withdrawn from social security;
- undeclared supplementary work: additional undeclared work done by a worker for the employer he normally works for, or abuse of part-time work schemes;
- fraudulent application of specific contracts: bogus self-employment, fraudulent practices in subcontracting (especially in the construction sector);
- different legal, semi-legal and sometimes criminal construction work with foreign workers (both European Economic Area – EEA – and non-EEA).

### Different forms

With regard to contribution fraud, it is possible for an employer to fail to make payments to social security institutions during a period of six months (contributions have to be paid quarterly), go bankrupt and disappear from the market, reappearing under another company name.

The construction sector has to deal with major issues concerning bogus self-employment. This is not only a concern when it comes to foreign companies, but also an internal problem with domestic companies. Partial self-employment (that is, work conducted in addition a regular worker's main activities) is a threat to regular construction work. Those who are temporarily self-employed are alleged to engage more than occasionally in undeclared labour, making a minimal number of invoices at very low prices. Partial self-employment is attractive due to lower social security contributions, lower taxes, lower administrative burdens and the safety net of the main activity as a worker. The sector now has a growing number of pensioners, disabled persons, civil servants and construction workers who are engaged in partial self-employment: this proportion has increased from 22.4% in 2000 to 25.3% in 2004.

For the past couple of years, the inspection services have noted a considerable increase in the activities of foreign workers and companies. These activities often linked with unfair competition. Fraud related to the posting of workers is a considerable problem, as is disrespect for minimum wages and other labour conditions. These practices constitute social dumping of the workers concerned and can even lead to or be linked with criminal activities, such as human trafficking. Posting fraud can be divided into four categories: the incorrect declaration of the activities, posting fraud constructions, falsification of posting declarations, and fictitious posting.

Inspection services have now recognised the very low prices offered by foreign companies, their use of intermediaries on the market or dubious posting agencies (especially Dutch agencies since the liberalisation of the market in 1998) and an increase of posting from Central and Eastern Europe (CEE). Since EU enlargement the number of abuses has grown. The evolution is hard to curb due to the complexity of cases, lack of administrative cooperation between Member States and lack of information on the applicable legislation. Bogus self-employment of workers from these countries is another major issue causing enforcement problems. Problems are also caused by the fact that transitional measures have been imposed with regard to the free movement of workers from eight CEE Member States.

### Extent

There is a wide consensus that there is a lack of reliable figures and studies on undeclared labour in general, and specifically in the construction sector. Most of the available data do not represent reality, but the 'controlled reality', such as figures in inspection reports. It is acknowledged that construction is one of the most fraud-sensitive sectors, alongside catering, gardening and personal services like cleaning or babysitting.

In the absence of precise data on undeclared labour, the only way to establish its size is by means of direct surveys of Belgian families or via indirect methods. According to an inquiry in the 1980s, a quarter of all families would from time to time perform undeclared labour and do so at an average of 33 hours a month. The main categories involved were young households and low-skilled workers. This accounts for approximately 6% of the total formal labour volume. At the time occasional undeclared labour was alleged to be three times as important as organised 'permanent' undeclared labour.

In international macro-economic studies, Belgium is frequently cited as a country with a high percentage of undeclared labour. A European Commission study of 1998 situated the informal economy between 12 and 21% of the GDP, which placed Belgium among the EU countries with the largest informal economies such as Italy, Greece and Spain.

The most recent Belgian study on undeclared labour dates from 2003. This research does not provide new estimates regarding undeclared labour and only tries to give an overview of the existing data with a focus on the 'controlled reality'. Social security contribution fraud is estimated at 6.8% of total social security contributions, representing a contributions loss of € 1.879 billion.

In a 2004 macro-economic study, Belgium's informal economy – with an estimated average size of 21.5% of GDP – was part of a group of EU countries exceeding the level of 20%. The other countries were Greece (28.3%), Italy (26.2%), Portugal (22.3%) and Spain (22.3%). This informal economy equals € 57 billion.

According to the PROSPERO-report on the Belgian economy, the government loses about € 30 billion of tax revenues due to the informal economy. The black market represents 22% of the GDP. About one-fifth of the working age population performs undeclared labour full-time, part-time or occasionally.



## Functioning of the undeclared labour market

### Actors

To a large extent, the supply of and demand for workers in the informal construction market is communicated by word of mouth between private individuals and between employers. In certain regions, some families have a reputation for their involvement in undeclared labour. They explore the market and offer their services to potential customers. They receive the minimum wage of a bricklayer and some extra ‘envelope’ money, often paid per metre. After the work they are dismissed and search for a new site. In most cases, Belgian workers are not completely undeclared, but partially regular in one way or another.

With regard to fraud in the employment of foreign workers, advertisements from foreign temporary labour or posting agencies are sent via e-mail or fax to construction companies, offering very attractive prices. These prices often reveal that Belgian minimum wages could not possibly be respected. Foreign workers often get engaged in undeclared labour via intermediaries, sometimes dubious posting agencies (often Dutch) or individuals engaged in gangmaster-like activities.

The trade unions have an ambiguous position in the debate on undeclared labour. On the one hand, they are against all kinds of social fraud because it undermines social protection and it leads to a destabilisation of the labour market. On the other hand they represent workers who are potentially involved in undeclared labour. Employers’ organisations have a similar problem in the relationship with their members. Even the government has to deal with an ambiguity towards its voters: while the fight against undeclared work by foreign companies features in many government campaigns, measures to address undeclared labour (such as moonlighting) by Belgian private individuals have typically been addressed in a more subdued way.

### Segments

Certain construction work – mainly indoor work, such as painting, renovation or wallpapering – is ideal for undeclared labour. The actors in the formal economy are not really interested as fixed costs are too high to engage in this kind of work, so the opportunity is available for undeclared labour, now often performed by Polish workers.

As working in construction involves a lot of hard physical labour, most of the undeclared workers are young males between the age of 18 and 45. Younger people are probably also more susceptible to fast and easy ‘in pocket’ earnings.

Most undeclared workers have low to average levels of skills. More information about vocational qualifications is not available and no conclusions can be drawn about workers’ levels of experience in the field. People involved are not only from the sector, but also workers from other sectors (for example, teachers, policemen, shift workers in other sectors and part-time workers). A well-known category is persons receiving social security benefits, such as pensioners or unemployed persons.

The nationality of the greatest number of undeclared workers is Belgian. After this, Eastern Europeans, then Portuguese, and then non-EEA workers constitute the largest groups represented.

Small and medium-sized enterprises are more likely to use undeclared labour than bigger companies. There is enough evidence available to state that 90% of the bigger companies will not be involved in using undeclared labour. One of the main reasons for this is the higher degree of professional administration and management in big companies. In companies with less than 30 workers two strong regulating factors are missing: management and administration staff, and the presence of trade union delegations.

The level of involvement in undeclared labour also depends on the type of construction activity. Demolition has been referred to as 'cowboy land', where abuse is the order of the day, particularly in terms of health and safety at work. Excavation and cable works are also areas which involve a lot of migrants in undeclared labour. In contrast, some construction work is characterised by a very low level of undeclared labour. This is generally work which requires highly specialised or very specific activities, such as dredging or electrical work.

The level of undeclared activities also depends on whether the customer is a private individual, a company or a public authority.

## Reasons

Clearly the motivation for all involved in undeclared labour – customers, undertakings and workers – is the financial advantage it offers. For the customer, they do not have to pay VAT when an undeclared worker performs the work. For an employer, their costs are reduced as they avoid paying social security contributions. The worker also avoids social security contributions and income tax. It should be noted that the clearest indicators are overdue debts in social security contributions or in FBZ contributions. Roughly said, a customer wins 21%, the undertaking 50% and the worker between 30 to 40%. Compared to the financial aspect, other motivations are of much less importance.

The structure of the labour market is a final determining factor. As has been stated above, construction is a sector where the threshold to enter it is very low. This makes the market fragmented and dominated by a large number of very small companies, which are very fraud sensitive. Specifically, employers are sometimes very 'hard to catch' because of their mobile working places, which can be a stimulus for involvement in undeclared labour.

## Dynamics

Internationalisation and globalisation of the market is a critical factor in determining levels of undeclared labour. In particular, the European internal market has had an enormous effect on the incidence of undeclared work. Increasing cross-border mobility of workers can be related to different forms of social fraud and other illegal practices. The abuse of the free provision of services is an outstanding example, leading to the use of bogus self-employment, posting fraud, unfair competition and social dumping.

Another important factor is the development of outsourcing and subcontracting activities. Although subcontracting per se is completely legal, many abuses are

observed in this field. This is because of several reasons: the complexity and difficulty of controlling subcontracting chains, and the problem of educating subcontracting companies on the topic of undeclared labour. Without doubt, the more subcontractors there are on a construction site, the higher the risk that undeclared labour will be present.

A third key factor is the immense labour costs in Belgium.

## Effects

First, undeclared labour puts pressure on productivity: it helps companies with low productivity to stay in business by using the profit from the undeclared labour. It also challenges the growth of enterprises which have higher productivity levels and show respect for legislation. This clearly constitutes unfair competition.

Undeclared labour endangers the respect of working conditions and social insurance rights in the regulated formal labour market and undermines the industrial relations system with industry-wide provisions and regulations established for the sake of continuity in the sector. It also leaves workers involved in undeclared labour without social protection and creates social pariahs. Considerable pressure is placed on Belgian workers in case foreign workers on a construction site work more hours at lower wages.

For the governments, undeclared labour mainly represents a loss of revenue. Undeclared labour and social fraud lead to a weakening of the social security system and of the complementary social benefits that accompany a solidarity base.

Finally, undeclared labour makes the construction sector unattractive to young people and other potential construction workers, and has led to a poor public opinion of the sector.

## Measures

A Protocol on Cooperation was introduced on 30th July 1993 to enhance the collaboration between the different inspection services involved in the fight against social fraud. It has resulted in a more integrated approach and was extended to all regional inspection services in 1995. However it soon became clear that cooperation still needed to be improved. This was the aim of recent legislation introducing a Federal Council and a Federal Coordination Committee for the fight against illegal labour and social fraud.

One of the most important provisions in the fight against undeclared labour was the introduction of the registration of contractors linked to a system of multi-staged joint liability and a deduction obligation for social security and tax purposes. This section will consider the principles of the system since 1999. Named after an article in the law on the National Office for Social Security and called the Article 30bis system, it was introduced specifically for construction, in particular to combat fraudulent practices by so-called gangmasters. Under the system of joint liability, the customer (everyone commissioning the execution of certain works at a certain price) who, for

specified construction works, appeals to a contractor not registered at the time of the conclusion of a contract, is jointly liable for the payment of social debts of his contracting partner.

The other component of the Article 30bis system is the working site notification. Before the work is started, a contractor to which a customer appeals for specified construction works, must provide all information to the social security institution to enable it to estimate the importance of the work and to identify both the customer and all subcontractors at any stage. If other subcontractors intervene during the period of execution of the work, the contractor must notify the social security institutions in advance. As a consequence, every subcontractor should notify the contractor in writing on the intervention of a new subcontractor.

### Recent developments

For years, the fight against undeclared labour and social fraud has been mentioned in government policy statements and in key government addresses. Combating illegal labour and social fraud has gained renewed importance since the middle of the 1990s. After 1999 emphasis was put on the modernisation of the government and administrative simplification. Since 2003, the emphasis has moved to prevention and control on undeclared work, especially by reforms regarding the tools and actions of inspection services, the sanctioning and the involvement of the social partners. The Ministerial Council of Gembloux in January 2004 was a landmark in the fight against undeclared labour and social fraud. This Council produced an extensive note named 'Respect for Social Solidarity', containing a number of necessary measures with regard to controls and sanctioning:

- better cooperation between the social inspection services;
- extra staff for the social inspection services;
- central planning and steering;
- databases for better controls;
- modification of the legislation concerning the inspection services;
- awareness-raising campaigns;
- administrative simplification leading to better controllability;
- effective social criminal law;
- joint liability in other sectors than the construction sector;
- the introduction of specialised chambers in the criminal courts;
- measures relating to different target groups;
- measures relating to the problem of bogus self-employment.

The bulk of measures (some of which were already enacted or in development before Gembloux) can be divided into three categories: administrative simplification, improving control and enforcement, and awareness-raising and involvement of the social partners.

## Administrative simplification

The establishment of e-government in the social security system has meant a simplification of administrative procedures for both employers and authorities. A number of key measures are described here.

### *Crossroads Bank for Social Security*

Since 1990, social security institutions are linked via an electronic network. This process has led to a successful combination of administrative integration (involving 2000 social security institutions) and an e-portal solution, which serves as an example for Europe.

### *DIMONA (Déclaration IMMédiate – ONmiddellijke Aangifte)*

Since January 1st 2003, all employers have to declare a new employee electronically to the National Office for Social Security (the system was tested on employers in construction). A circular of 2nd December 2005 provides a procedure by which local authorities can request a special number with the central social security database for the foreign occasional employees who temporarily come to work in Belgium, so that employers can make their Dimona declaration. These employees have to report to the local authorities, even when they are staying in a hotel. One of the advantages of making a correct declaration is that the employer does not have to keep a general personnel register as the existing personnel file is always known electronically.

### *Multifunctional declaration (DmfA)*

In the past this declaration was only used for the calculation of social security contributions. All social security institutions now use the transferred data for different purposes. The employer must declare the wage and performance data of every worker and the contributions for the whole company. Depending on the data given, the employer is entitled to a number of reductions. The status of the employee and his/her type of employment are what decide these.

### *GOTOT-in / GOTOT-out*

#### *(Grensoverschrijdende Tewerkstelling-Occupation Transfrontalière)*

The cross-border employment database collects all information on incoming foreign workers (GOTOT-in) and outgoing posted workers (GOTOT-out). The database collects all the information and can be consulted by the inspection services of the National Office for Social Security, the FPS Social Security, the FPS Employment, Labour and Social Dialogue and the National Employment Office (RVA). The GOTOT-out database is an application for full automatic treatment of posting applications by workers who habitually work in Belgium.

### *Notification of social risks*

Electronic notification of social risks has to be executed when a social risk can give rise to maternity benefits, benefits for accidents at work or for occupational diseases, unemployment benefits, income guaranteeing benefits and wage subsidies. As soon as social risks occur, the employer, the insured person or their representative has to inform the social security institutions.

### *Notification of temporary unemployment*

Notification for temporary unemployment is possible for certain employers in the possession of a user-id and a password for the social security web portal. The data enable the National Employment Office to check the legality of the temporary unemployment. If it is not valid, this is immediately reported to the employer or afterwards, as some conditions cannot be controlled in the notification (for example, bad weather).

This large administrative simplification project has been very beneficial to the fight against undeclared work and social fraud. E-government applications make sure that there is unique identification of every citizen and every undertaking. Certain facts are declared immediately or even beforehand to the competent authorities and there is a guarantee that the same information is used for the calculation of contributions and benefits. Finally the public accessibility of information with regard to social debts of undertakings has an advantageous warning function, especially in construction where it is linked to the system of joint liability and deduction obligation for customers and other contractors. The greatest advantage of the applications is the fact that it increases the information base for inspection services and it becomes easier to know and control the situation of companies and workers.

### *Improving control and enforcement*

During inspections and in actual enforcement, services are confronted with several legal and practical problems, not in the least due to internationalisation. Moreover, lots of cases are not brought to court due to a lack of staff in the Labour Auditory (public prosecutor in social matters) or simply to other matters being prioritised. Nonetheless some fundamental changes took place since 2003 in control and enforcement.

The starting point was the introduction of the Federal Council and the Federal Coordination Committee for the fight against illegal labour and social fraud, and the district cells by the law of 3rd May 2003.

The Ministers for Work and for Social Affairs plan to transform the newly introduced institutions into a Social Inquiry and Tracing Service (SIOD) as successor of the Federal Coordination Committee, working with its own staff (instead of posted staff from involved administrations) under the supervision of a public manager reporting directly to the Minister. The SIOD will initially function as a support and knowledge centre, starting its steering role in 2007. Actions will be assessed by means of a professional evaluating system with measurable indicators to evaluate the actions continuously and steer them if necessary.

Within the inspection services of the FPS Employment, Labour and Social Dialogue, a special team has been incorporated in the Department for the Control of Social Laws to deal with fraud related to the activities of foreign undertakings and workers. In the same department, a specific guide was elaborated, aiming at a unified approach of the practical problems encountered and to give a clear signal to the service sector and the social partners that the concerned inspection services take cross-border fraud, social dumping and unfair competition seriously.

One new measure is the LIMOSA-project (Landenoverschrijdend Informatiesysteem ten behoeve van MigratieOnderzoek bij de Sociale Administratie). This federal government project is part of the modernisation of the social security, and works out an electronic system for monitoring and controlling every form of employment of foreign workers. It will result in a single point of contact for the coming generalised prior notification obligation for all posted workers and self-employed persons (they have to declare their activities before starting).

#### *OASIS (Organisation Anti-fraude de Services d'Inspection)*

OASIS is a data warehouse that was created in the frame of a common anti-fraud project of the inspection services from the FPS Employment, Labour and Social Dialogue, the FPS Social Security, the National Office for Social Security and the National Employment Office (as the four main actors). Its main purpose is to enable the social inspection services to execute goal-oriented controls and to perform analyses on related data from different social security sectors. In other words, it is a tool created to detect and analyse fraud scenarios.

#### *GENESIS*

##### *(Gathering Evidences from National Enquiries for Social Inspection Services)*

GENESIS is a database comprising two modules: the first is a combination of basic data from control visits of the different inspection services by filtering all data from the computer files on a daily basis; the second is a module to enrich the controls by combining all data that are actualised on a daily basis, like the official address of a company or Dimona-data. It is the synthetic register of all closed and pending controls of the inspection services from the FPS Employment, Labour and Social Dialogue, the FPS Social Security, the National Office for Social Security and the National Employment Office (the four main actors).

### **Awareness-raising and involvement of social partners**

The law of 3rd May 2003, mentioned earlier, established a Partnership Committee. The committee has to prepare Partnership Agreements between government and professional organisations. The aim is to involve sectors in the three phases of the fight against undeclared work: prevention, tracing and repression. A model for Partnership Agreements and a procedure to conclude these have been developed.

The Bouwpool (Construction pool, 2001) in Antwerp is a local initiative of the social partners aimed at the employment of certain risk groups. Some 70 nationalities are involved in this project. Workers are guided through a process from education over training to (guaranteed) employment, financed by the sector and the Antwerp city.

Trade unions try to work with the communities of foreign workers by making links with key individuals at worksites, churches and lodgings. Unions distribute flyers (mainly in Polish) which contain valuable information for workers, including information on the minimum wage and other labour conditions. Workers are informed that if they have a double nationality (Polish-German), they can be recruited directly by a Belgian employer under the free movement of workers.

A taskforce on unfair competition within the joint committee of the construction sector is focusing on unfair labour migration, the provision of working cards and permits, the validation of training for job-seekers and the limitation of partial self-employed.

## Good practices

As a lot of the measures have only been put into place very recently, it is important to be circumspect about their evaluation. With regard to e-government, Belgium can play a leading role in the EU. The social security web portal is a user-friendly and timesaving instrument for social insured persons, for undertakings and for the authorities. The easier it is for all kinds of data to be registered, the greater the overall knowledge of the authorities.

The overall e-government project has been nominated as one of five 'best practices' in the European, Central and Local Government eCo-operation and Public eServices awards. As a result of this project all concepts, procedures and administrative instructions were standardised across all social security sectors. Some 170 sorts of paper certificates that the socially insured persons or their employers had to get in one social security institution, only to hand it over to another social security institution, were replaced by electronic messages. In 2002, 243 million data exchanges took place between social security institutions. About 50 sorts of social security declaration forms have been eliminated entirely, and in a further 30 declaration forms the number of headings has been reduced on average by two-thirds. A lot of declarations can now be entered directly and electronically from the personnel administration packs or in real time (on-line) via the social security portal, for example, the immediate declaration of employment and discharge (DIMONA, unique in Europe, now taken up by the Netherlands) and the quarterly declaration to the National Office for Social Security. An ever-increasing number of social security rights are granted automatically without administrative declarations for the socially insured person or his employer.

Another powerful instrument is certainly the GOTOT-in database which collects all information on incoming foreign workers. This could be a very useful tool to introduce in every country of the EU in order to make it possible for the different national administrations to check the GOTOT-database of other Member States and thus increase their knowledge on foreign undertakings and workers. The same is possible for the GENESIS-database. The EU has already shown interest in introducing the GOTOT database as a general norm.

Fixing a lump sum for part of the contributions of employers to sector-specific joint institutions like the Belgian FBZ with an impact on the hourly rate from a certain moment and the reduction of the cost for working overtime are both considered as good incentives to work more in the formal market. Measures to combat abuse of temporary unemployment are necessary.

Almost all actors involved are in favour of the introduction of a joint liability system for customers and contractors on a European level. The introduction of a 'social Europol' was reiterated and so was the need for European initiatives relating to better administrative cooperation between the Member States.



# Czech Republic<sup>9</sup>

## Regulation and institutions

### Legislation

The following national legislation covering employment in construction is currently in force:

- tax regulations:
  - Act No. 586/1992 on income taxes, as subsequently amended (applicable to individuals and companies);
  - Act No. 235/2004 on value-added tax, as subsequently amended;
- social security regulations:
  - Act No. 589/1992 on social security contributions and contributions to state employment policy, as subsequently amended (covers sickness insurance, the national pension scheme, and contributions to state employment policy);
  - Act No. 592/1992 on general health insurance contributions, as subsequently amended;
- labour law regulations:
  - Act No. 65/1965, the Labour Code, as subsequently amended;
  - Act No. 435/2004 on employment, as subsequently amended;
- health and safety at work regulations:
  - Act No. 174/1968 on state supervision of safety at labour, as subsequently amended;

<sup>9</sup> The basic country report was written by Jaroslav Kux and Ales Kroupa, Research Institute for Labour and Social Affairs, Prague, Czech Republic. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

- special regulations for construction:
  - Act No. 50/1976, the Building Code, as subsequently amended (covers the conditions for construction projects);
- business entrepreneurship:
  - Act No. 455/1991, Trade Law, as subsequently amended;
  - Act No. 513/1991, Commercial Code, as subsequently amended.

These regulations entail obligations (tax, welfare and health insurance contributions, employment laws and workplace health and safety regulations) for employees, employers and self-employed persons:

- tax regulations (lower tax rates apply with effect from 1st January 2006):
  - income tax (employees, self-employed persons) – tax rates are 12, 19, 25 and 32 % of income;
  - corporation tax (business entities) – tax rate is 24 %;
- social security regulations (social security contributions, contributions to state employment policy and general health insurance contributions);
  - total contribution for employees – 47.5 % of wages (12.5 % paid by the employee, 35 % paid by the employer);
  - total contribution for self-employed persons – 47.5 % (43.1 % excluding optional sickness insurance).

## Collective agreements

Collective bargaining at sector level takes place between the leading employers' association, the Association of Entrepreneurs in Building Industries in the Czech Republic, and the Trade Union of Building Workers. This results in a national industry-wide collective agreement. The sectoral collective agreement extends to the entire construction sector, and therefore also applies to companies where there are no trade unions and which are not members of an employers' association.

At the company level, the employer negotiates company collective agreements with union representatives, who may be affiliated to the Trade Union of Building Workers or be independent of the major unions. In the construction sector the generally binding collective agreement applies to a substantially greater number of employees than company collective agreements. The generally binding collective agreements also relate to subcontractor relationships. The purpose of this provision in the sectoral collective agreement is to prevent abuse of subcontracting arrangements with companies with illegal employment arrangements.

## Authorities and institutions involved

The following national institutions are responsible for individual regulatory systems and compliance with the relevant regulations:

- tax regulations:
  - revenue authorities (at various territorial levels): administer and record tax and deductions, control compliance with tax regulations, apply sanctions;

- social security regulations:
  - social security administration (with offices at territorial level): implement pensions and sickness insurance benefits, including payment of benefits and labour inspection;
  - health insurance companies: provide health insurance;
- employment law regulations, including health and safety at work:
  - employment offices (at territorial levels): provide consultancy services, implement active and passive employment policy measures and payment of relevant social security benefits, issue permits to employ foreigners, and control compliance with employment law and equal opportunity principles;
  - labour inspectorates (at territorial levels): control compliance with collective agreements, labour law, health and safety at work regulations;
- cooperation to control the employment of foreigners:
  - the Aliens Police of the Czech Republic and the customs authorities;
- administration of the law/jurisdiction:
  - courts (at territorial and higher levels): criminal law, civil law and other proceedings;
- local government administration:
  - trades licensing offices or departments: arrangements for conducting trades, controls concerning businesses in trade, application of penalties and other sanctions;
  - building authorities: applications for building permission, including labour control and sanction measures.

## Nature and features of undeclared labour

### Definition

In practice, no uniform definition of undeclared labour is used in the Czech Republic. According to national legislation, it is necessary to observe a number of regulations, based on an individual's employment status (that is, employee, self-employed), in particular:

- the existence of a proper employment contract, including compliance with all labour law and wage regulations;
- the registration of the company in the commercial register, kept by the courts;
- the registration of self-employed persons in the register of trades kept by the trades licensing offices;
- registration with the revenue authorities and compliance with tax obligations;
- registration with social security offices and compliance with social security obligations;
- registration with health insurance companies and compliance with general health insurance obligations;
- compliance with other related registration or record-keeping requirements, for example, statistics authorities, employment offices and so on.

From the narrow point of view of each individual authority and institution, the criterion of declared or undeclared labour is compliance or failure to comply with the regulatory measures they prescribe. Nevertheless, for the purposes of a uniform overall assessment of the character of labour, the most recent generally recognised EU definition from 1998 has been adopted and applied for operational purposes, in relation to OECD and ILO definitions: “undeclared work can be defined as any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account the differences in the regulatory systems between Member States”. Of course, individual countries can use such a description as an acceptable definition, but there are differences in individual countries’ regulatory systems and this entails a certain international incompatibility of the information and data acquired.

The only official national definition concerning illegal labour is formulated relatively narrowly in the Employment Act: for the purposes of the Employment Act, illegal labour is understood as a situation in which an individual does not work for a company or is not self-employed on the basis of a labour law relationship or other agreement (if that does not concern the spouse or children of that individual, or a partner or member of that company), or where a foreigner does not work for a company or is not self-employed on the basis of a labour law relationship or other agreement (and this does not concern the same persons as in the preceding instance), or works contrary to the work permit issued, or without such a permit (if a work permit is required pursuant to the Employment Act).

### Different forms

A basic typology of the forms of undeclared labour in construction (not ranked according to importance) can be characterised as follows:

- individuals working for themselves, for the most part undertaking repairs or small-scale plumbing and construction work for households – as a rule these are Czech citizens with direct connections to their customers who pay them in cash (they perform this work either as part of their main employment or as a second job following their regular work);
- self-employed persons (small traders) who often work without proper accounting documents and receive payment directly from customers;
- the bogus self-employed, for example, a person working for a company as a subcontractor instead of having a regular employment with the company, which is contrary to the Employment Act;
- a pyramid of subcontractors with a single main contractor at the apex who hires individual workers, or a ‘clientele system’ where the workers are largely employed illegally.

The extent of these activities is, as a rule, closely associated with economic cycles. Construction labour tends to be closely linked to booms or recessions in the economy as a whole. During boom periods there are labour shortages and increased demand for (unskilled) construction labourers, which tends to be accompanied by a rise in

declared and undeclared labour. Periods of recession dampen demand and lead to a consequent fall in declared and undeclared labour. In addition, the specific forms of undeclared labour depend on whether the labourers are foreigners or Czech citizens.

#### *Undeclared labour of foreigners*

The forms of undeclared labour of foreigners include:

- foreigners working in the Czech Republic illegally (without work permits) for employers, predominantly small construction companies, for the duration of their tourist visas, or working without residence or work permits;
- foreigners working illegally (without work or residence permits) for a company that is one of many subcontractors for a large construction company, where the subcontractor supplies only workers and no means of production: in such a company, some foreigners are working legally and some illegally;
- foreigners working illegally (without work or residence permits) for a licensed temporary employment agency that is authorised to contract out its own employees pursuant to the Employment Act, usually to large construction companies.

On this last point, some foreigners are working legally and some illegally. A commercial law relationship pursuant to the Commercial Code applies between the construction company and its subcontractor or agency for work that is undertaken. However, these subcontractors and agencies can breach the regulations in other ways (in addition to illegal employment). Often no employment contract exists between the employee and the subcontractor or agency, or an employee commences work before the employment office issues a work permit, or continues working after their permit has expired. Subcontractors or agencies often request an excess number of work permits for foreigners, who then work for other employers. Often there is a failure to comply with wage regulations and regulations governing health and safety at work. Working hours are not adhered to, and the place of employment does not correspond to the work permit.

Undeclared labour by foreigners also takes the form of 'quasi-business' relationships. Two laws – the Trade Law for Small Enterprise and the Commercial Code for Business Entities – govern the establishment and operation of business activities by foreigners. The Trade Law is most frequently abused by foreigners. It is relatively liberal in nature: for unregulated trade it does not impose any special restrictions on enterprises. Foreigners do not ask employment offices to issue work permits, but operate as entrepreneurs. A relatively large proportion of foreigners therefore use their trade licenses for quasi-business and operate as bogus self-employed people. They formally operate businesses, but in fact are in a subordinate employment relationship with another entrepreneur, as one of them does not act in his or her own name and is without liability, which is how the Trade Law defines business activity. In operating a trade, foreigners often fail to meet their legal obligations, such as paying their tax, health insurance and social insurance contributions. A trade licence can in essence be obtained for any kind of activity. The trade licence office does not investigate whether the applicant has the means of production required for the

performance of the activity in question. According to employment staff, since the new Employment Act has come into force prohibiting such business, they are decreasing and being replaced by employment through agencies.

The Commercial Code is used to a far lesser extent than the Trade Law to legalise residence, or for quasi-business. This is because establishing a company under the Commercial Code is much more costly: business entities and cooperatives, with the exception of general commercial partnerships, must deposit an amount of some tens of thousands of crowns. But still it is occasionally used to obtain access to the labour market, or to legalise residence. To that end, the most widespread forms of business entities are limited-liability companies and general commercial partnerships or cooperatives. Often tens of people establish a single limited-liability company or cooperative. According to the new Employment Act, partners in a business entity who are simultaneously employees of that company or cooperative are required to have work permits.

#### *Undeclared labour of local workers*

Forms of undeclared labour of local workers include:

- unemployed citizens, or persons who are otherwise economically inactive, working individually for a construction company without employment contracts and who do not have tax and contributions deducted from their wages. This can also include citizens working illegally for a company that is a subcontractor for construction labour, or an agency that only supplies employees to a construction company. In a subcontractor or employment agency, only some employees are employed illegally;
- citizens in regular employment who, in their free time, undertake various kinds of work and services without any kind of authorisation, in return for payment, and who do not pay compulsory contributions and tax on this income;
- repeated employment (more than is permitted by the Labour Code) on a fixed-term employment contract. An employment relationship for a fixed term between participants (the same employer and employee) can be arranged or extended, by mutual agreement, for a maximum of two years. This applies to every additional fixed-term employment relationship arranged in the period in question between the participants. However, this restriction does not apply to cases defined by law where a fixed-term employment relationship is agreed;
- the loan of machinery with operating personnel, which was in the past covered by a provision of the Labour Code concerning the temporary assigning of employees. Many construction companies still incorrectly practice the lending of employees in accordance with the now invalid legislation. Until the new Employment Act came into force, the temporary lending of employees was allowed. But the previous legislation did not provide sufficient protection of the rights of temporarily assigned employees, and was therefore abolished. Now, only employment agencies that have obtained permits for that activity may temporarily assign employees; in other cases this practice is illegal;
- 'quasi-business' arrangements where one entrepreneur 'employs' another 'bogus' entrepreneur. Instead of employing a worker in a labour-law relationship (on the

basis of an employment contract), the former seeks to negotiate a commercial law contract. This should be a relationship between two independent entrepreneurs, but is in fact an employment relationship in which one party is dependent on and subordinate to the other (fixed working hours; the use of the employer's means of production, energy, raw materials or tools; employment is performed solely at the employer's place of work and so on). This is not two parties engaged in enterprise, as the activity does not display any of the essential features of enterprise (that is, systematic activity performed independently by the entrepreneur in their own name and who carries the liability, for the purpose of achieving a profit). The employer's motivation for using this system is to attempt to simplify the wage and accounting responsibilities, and above all to reduce expenses (in this situation it is not necessary to pay compulsory contributions, as in the case of an employee). Another motivation is an attempt to exclude the applicability of the Labour Code, which protects the employee far more than the aforementioned contract negotiated between so-called entrepreneurs;

- other forms of illegal employment, where every instance in which the relevant laws are not observed is illegal, include:
  - untaxed income for labour performed;
  - an employee's wage which consists of the subsistence minimum and a supplement from which obligatory deductions and tax are not paid;
  - failure to pay the bonuses stipulated by law, erroneous classification in wage tariffs and failure to observe labouring hours;
  - one company lending employees to another company and claiming for business travel, with a duration in excess of one month;
  - situations where, in addition to regular working hours, an employee works for the same employer under an employment agency, where he/she has secondary employment, with the aims being to reduce wage costs for overtime payments and to exceed the limit for overtime labour defined by law.

## Extent

As part of this report, an attempt has been made at an accurate estimate of the extent of undeclared labour in construction. Although the calculations can only be very approximate, the analysis reveals that the extent of undeclared labour in construction is considerable. Two methods were used.

The first method used a calculation based on the first Czech national labour accounts for 1998 with certain new calculations, compared with other data sources and the results of consultation (the balance of the population's activities, estimates for illegal immigration based on data from the Aliens Police, results of investigations performed jointly by employment offices, financial and other institutions, consultation with trade union bodies and employers' associations in construction). As has already been said, reliable estimates of the extent of undeclared labour are difficult to make, although based on the sources listed the potential extent of undeclared labour in construction, including work performed in the form of second jobs (moonlighting) and other forms of undeclared labour, is possibly 35-50% of the levels

of declared labour. An estimate of the extent of illegal labour by foreign workers is between 40,000 and 50,000 (compared with approximately 45,000 foreigners working legally in the sector). The extent of undeclared labour performed in various forms by Czech workers, regularly or occasionally, is much greater; potentially 100,000 to 150,000 (according to statistical company records, declared labour in construction accounts for approximately 400,000 jobs). By way of illustration, with a very rough estimate of 250,000 to 350,000 persons working illegally in the Czech economy as a whole (5-7% of the labour force), the proportion of undeclared labour in construction is around half that figure.

The source for estimates of illegal Czech workers is the first Czech labour accounts based in principle on LFS results (which points to higher real employment in construction than that officially reported by establishment surveys), along with some other expert assumptions to help estimate the probable portion of the hidden economy covered by this method. Estimates of the extent of foreigners working illegally were based on discussions with construction experts (trade unions and employers). Surprisingly, both of these sources independently suggested approximately the same figures. These estimates were compared with official results concentrating particularly on selected problems of illegal labour by foreigners in the whole economy (no separate data for construction is available). These figures indicated partly lower numbers: foreigners working illegally amount to 35% of the number of foreigners working legally (in the construction sector the results are probably higher).

The second method was based on national accounting data. This primarily concerns the Eurostat pilot project 'Exhaustiveness', which was launched in 1998 and aims to ascertain how completely the economy is captured in countries' national accounts. According to data from that project, the proportion of the shadow economy in construction accounted for around 20% of the gross added value in that sector in the Czech Republic. After the accommodation and catering sectors, and other personal service sectors, the construction sector, along with the retail sector, was the next most significant in terms of not covering the proportion of actual value of labour in the sector. Although this concerned the proportion of the 'shadow' economy in terms of the statistical capturing of labour, it could be expected that undeclared labour was the decisive factor. The lower proportion of the shadow economy relative to GDP, compared with the estimated proportion of the extent of undeclared labour, results from the distinctive structure of undeclared labour in construction: predominantly the labour force is poorly qualified and badly paid and includes a considerable number of people with second jobs (moonlighting).

An analysis of the data reveals that the greatest extent of undeclared labour was in the initial period of economic transformation, in the first half of the 1990s. The pre-transition period was characterised by the non-existence of the private sector. Only in the last years before transition were some exceptions officially admitted, based on special permits of local administrative bodies – for example, repair of electronic equipment, dressmaker activities, smaller construction activities and so on, mostly in the form of second jobs and with a negligible number of persons involved. In construction these activities were mostly connected with the building or maintenance of family houses with the help of relatives, friends and neighbours, and later also using



the services of people with special permits. Quite often these activities were carried out illegally, but no estimates exist.

In the first years of transformation there was an exaggerated emphasis on the automatic functioning of the market, relevant legislation was lacking and control mechanisms were minimal. As legislation was gradually developed and controls became more effective, there was a gradual decline in the extent of undeclared labour (from the mid-1990s onwards). That trend need not of course apply in full to construction, especially as there were rising numbers of foreigners working illegally in the 1990s.

## Functioning of the undeclared labour market

### Actors

The most common cases concern the employment agencies or subcontractors founded by citizens of Ukraine or other former Soviet Union countries. The agencies or subcontractors prepare contracts through personal contacts with the management of construction companies, sometimes even in the form of public competitions (both agencies and subcontractors are legal bodies, with at least some of their employees working on a legal basis). The agency is hiring out its employees in accordance with the law (it is the purpose of its activity), while the subcontractor is in practice hiring them out too, however in the form of a subcontract of some construction activity. The agency then issues invoices for the hiring out of labourers while the subcontractor invoices for fulfilling a contract. In both cases undeclared labour occurs when some of the employees are working illegally or the subcontractor has only workers and no means of production.

Local people in undeclared labour are mostly engaged in a system with subcontractors or bogus self-employed people who, instead of working in a regular employment relationship, perform various kinds of labour as subcontractors. Czech workers also enter the illegal labour market in other ways, on the basis of informal relations between citizens, with illegal employment in the form of civic assistance or small-scale construction labour. Illegal ties are also often used in the form of bogus enterprise. Illegally employed workers enter the labour market under subcontracts, where a subcontractor or agency is used to implement a specific project. There is often a chain of subcontractor relationships, where the company that is last in line actually works on the project. This system is used to conceal illegal employment, to complicate the identification of illegal workers on a construction site and to create 'tax optimisation' (whereby a sum is paid to subcontractors which are only formally connected to the system and do not provide any work, but this sum is lower than what the invoice is issued for).

### Segments

The following main groups of actors in undeclared labour are closely associated with individual forms of providing such labour (not ranked according to their importance):

- illegal foreign workers (especially Ukrainians and Slovaks);

- regular company employees performing undeclared labour as their second job following their main employment (moonlighting);
- persons receiving social security benefits (pensioners, the unemployed) providing undeclared labour, often on an occasional basis, in order to increase their incomes;
- other persons not in regular employment, or receiving social security benefits;
- self-employed persons occasionally providing at least part of their labour in the form of undeclared labour.

The labour provided by these persons is, in the majority of cases, unskilled labour for construction and bricklaying and is frequently badly paid (especially the case for illegal foreign workers and persons receiving social security benefits). Sometimes, though, it also includes more demanding work, such as plumbing and other skilled labour. It appears that, in cases of undeclared labour, the size of the companies making use of such labour is not a big factor. In construction, it is found not only in small companies, such as small traders or enterprises, but also in large companies, although there is of course a difference in the forms of undeclared labour used. For small companies it tends to be an activity undertaken by individuals, small traders or persons working for themselves, while larger companies tend to cooperate with various employment agencies and subcontractors.

As far as the different customers are concerned, it depends often on the kind of person doing the undeclared labour:

- illegal foreigners are working mostly for smaller construction companies (as self-employed) or for labour agencies;
- regular company employees may work for their own employer in the form of a second job or for another employer, but they may also work for various individual clients (private households);
- persons with social security benefits and others not economically active are mostly working for smaller companies, self-employed people and households;
- self-employed persons who occasionally perform undeclared labour are mostly working for households or as subcontractors.

## Reasons

There are many reasons for undeclared labour in construction, applying both to companies using that kind of labour and the actors themselves. Due to the advantages of the system of undeclared labour both for companies and their clients, the 'goodwill' of the general population towards undeclared labour will probably continue.

For companies, the reasons for using undeclared labour may be purely administrative, but are often more to do with economic or practical benefits. They may use it to avoid:

- the relatively complicated and demanding regulations for founding regular companies or trades;
- the complicated process of obtaining work permits for foreigners;

- difficulties encountered in finding suitable regular employees for less attractive jobs;
- the relatively strict regulations of the Labour Code (which sets out legislation on dismissing employees, working hours, leave of absence, health and safety).

Economic rationales which look to make companies more competitive tend to prevail. This means finding ways to not pay tax, social insurance or health insurance contributions, only paying minimum wages and so on.

For workers engaged in undeclared labour, the reasons are also of an administrative and practical nature. Foreigners working illegally are confronted with the difficulty or impossibility of acquiring work permits. Combined with ignorance of local regulations and of the labour market, undeclared labour is the simplest way of obtaining paid work. In general, for people working illegally, undeclared labour is an opportunity to earn, or perhaps earn additional money alongside their regular wages or social security benefits, without paying tax and so on.

## Effects

The consequences of undeclared labour in construction are closely associated with the reasons why companies use that form of labour, and why the actors themselves use the system. The consequences for society as a whole tend to be serious, and can be briefly summarised as follows:

- interference with the competitiveness of construction companies or small traders;
- lower revenues for public budgets from income tax and corporation tax, value-added tax, and social security and health insurance contributions;
- failure to comply with regulations under the Employment Act, the Labour Code, Trade Law, Commercial Code, wage regulations and the relevant provisions of collective agreements, and therefore inadequate safeguarding of workers' rights;
- undermining the protection objectives of the social security system;
- creating the idea among the public that performing undeclared labour is acceptable and something that should not greatly bother anyone.

## Measures

Measures to combat undeclared labour are found in the relevant labour law regulations (especially the Employment Act), and are elaborated in more detail in the National Action Plan for Employment 2004-2006 (Guideline 9), in connection with the European Employment Strategy. These measures focus on the following areas:

- legislation:
  - simplifying and accelerating procedures to establish companies and trades, reducing corporation taxes (from 45 % in 1993 down to 31 % in 2000-03, and currently 24 %);
  - reducing income taxes for individuals (the two lowest wage bands from 15 and 20 % down to 12 and 19 %, along with the possibility of combined taxation for couples when this is more advantageous);

- planned reform of social security contributions;
- regular valorisation of minimum wages (in 2000 the minimum wage equalled 33 % of the average wage, in 2005 it was 38 % and in 2006 it is expected to achieve almost 40 %);
- opportunities for unemployed people to work while receiving unemployment benefit to a level of 50 % of regular working hours, or half the minimum wage;
- restrictive measures:
  - inspections in companies and at workplaces by employment offices and labour inspectorates, in collaboration with revenue authorities, the Aliens Police and so on;
  - the introduction of financial penalties levied by employment offices for undeclared labour (up to a level of CZK 2,000,000 – more than € 70,000 – for companies, and CZK 10,000 – € 350 – for individuals working illegally, with a fine of up to CZK 5,000 for individuals who refuse to provide evidence of their identity or other documents requested) – foreigners who do not submit their work permits will be expelled from the country, and unemployed persons will be taken off the register of job seekers and forfeit unemployment benefit. Overall, however, the system of penalties appears to be largely ineffective, as in practice fines imposed on companies are very low, more symbolic in nature, and for individual persons working illegally the fines are practically impossible to recover;
- education and raising awareness:
  - establish a general awareness of the fact that working illegally is not acceptable through articles in the national press, speeches by politicians at central and regional level, provisions in collective bargaining, the creation of a corresponding atmosphere in companies and so on.

## Good practices

According to the nature of undeclared labour, and experiences in combating undeclared labour, the emphasis is more and more on a combination of diverse measures aimed at individual aspects. It often happens of course that well-intended measures may yield contradictory results. For instance, take the new provision in the Employment Act which allows unemployed people to work up to 50 % of regular working hours, or for up to half the minimum wage, while retaining unemployment benefits. It was anticipated that this measure would legalise any illegal labour by unemployed people in the form of normal employment contracts or regular enterprise. In practice, it has often been the case that an unemployed person who was formerly working illegally (with an element of fear concerning potential inspections and penalties) has continued working, sometimes full time, still in the form of undeclared labour, while receiving full unemployment benefits, in many cases without any fear, due to the difficulties of controlling compliance with permitted working hours or earnings.

At present, the following can be regarded as generally successful measures, especially in larger companies:

- agreements between social partners on illegal labour and collective bargaining to combat unfair competition;
- the existing register of prices for construction labour and materials that companies use;
- control of labour by employment offices, labour inspectorates, revenue authorities and the Aliens Police, aimed in particular at illegal labour by foreigners;
- inspections, carried out in cooperation with trade unions, of compliance with health and safety at work regulations.

The activities of the established special Interdepartmental Body for Control of Illegal Employment of Foreigners – consisting of representatives of the Ministry of Labour and Social Affairs, the Ministry of Interior, the Ministry of Industry and Trade and of the Ministry of Finance – has proved to be very useful too, by coordinating the respective activities of these ministries and their organs. This interdepartmental body also concentrates on the fulfilment of tasks of the 'Action Plan for Combating Illegal Migration', adopted by the Government in 2004. The action plan includes a whole series of concrete tasks like the expansion of the competence of customs authorities and improvement of the performance in inspections of illegal employment and business. The aim is to find and implement measures that would minimise illegal migration to the Czech Republic and thus also contribute to the reduction of undeclared labour by foreigners. As most measures announced in the action plan were recently introduced it is still rather early to assess their concrete effects.

# Denmark<sup>10</sup>

## Regulation and institutions

The legislative framework concerning undeclared labour is primarily connected to the laws on taxes, duties, social security and so on. The legislation declares that it is illegal not to pay tax, duties or customs charges on goods and services. It is thus illegal not to declare earnings from work to the tax authorities. Undeclared labour is subject to fines and, in severe cases, imprisonment.

In July 2004, following an inspection campaign on undeclared labour, the minister responsible for taxation announced new measures, which include the following:

- all employees must be registered with the relevant authorities from their first working day. This is aimed at dealing with the situation whereby tax inspectors are often told that employees found not to be registered with the tax and social security authorities are on their first day of work and thus not registered yet;
- insurance companies must ensure that work carried out to rectify damages for which insurance claims have been made is declared properly;
- Dansk Tipstjeneste, the national football pools, lottery and gambling body, should terminate its contracts with retailers charged with tax fraud (it has contracts with 4,000 retailers).

Denmark has no legislation on minimum wages nor mechanisms for the extension of collective agreements whereby these agreements become generally binding ('erga omnes'). The Danish labour market is regulated by autonomous collective bargaining. Social partners have the exclusive right and responsibility to negotiate collective

<sup>10</sup> The basic country report was written by Jan Cremers, European Institute for Construction Labour Research, Utrecht, The Netherlands. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

agreements on general wage levels and other employment conditions. Employers belonging to the signatory parties are also obliged to apply these collective agreements to non-union workers.

So far, undeclared labour has not been a specific topic during collective bargaining in the private sector. However, the Danish Union of Wood, Industrial and Construction Workers (Forbundet Træ-Industri-Byg i Danmark, or TIB) and the General Workers Union in Denmark (Specialarbejderforbundet i Danmark, or SiD) have reached agreements with the Danish Construction Association (Dansk Byggeri) to undertake monitoring work in the construction sector in order to prevent undeclared and illegal labour that is not performed in line with the industry's collective agreement.

In January 2006 the Danish Labour Court ruled in two cases concerning the position of temporary agency workers in relation to the user company and the temporary employment agency. The judgement made it clear that temporary agency electricians must be given the same conditions as permanent staff. In his ruling the arbitrator argued that the Electricians Agreement is a sectoral agreement, which covers all work performed for a member company within the occupational field covered by the collective agreement. This argument is strengthened by the fact that the temporary agency workers were clearly working under the management and instructions of the employer of the permanent staff, in contrast to work performed by a subcontractor. The arbitrator further stated that the user companies are liable to pay the losses incurred by the temporary agency workers. It was the responsibility of the companies to inform the temporary employment agency that work done in the companies was covered by the Electricians' Agreement. This adjudication is binding in relation to temporary agency work in the electrician sector.

This does not mean, however, that the ruling has a general effect for all other sectors. In fact, Danish temporary agency work applies to at least three large sectoral agreements: the manufacturing industry, the service sector and construction. The agreement in building and construction follows by and large the pattern of the agreement in the manufacturing industry, which states that the workers are covered in relation to the Industry Agreement if the agency is a member of the signatory employers' organisation of the Confederation of Danish Industries (Dansk Industri, or DI). In addition to this, however, the construction sector – especially the trade unions – want the current agreement to cover also workers sent by subcontractors. This is a consequence of the special situation in the construction sector where it faces a significant problem: bogus self-employed workers and bogus companies based in Eastern Europe that are trying to circumvent the transitional scheme in relation to workers coming from the new EU Member States.

The conclusion is that no single general provision regulates temporary agency work at national level, and that the sectoral context of the work is decisive. This is proof of the flexibility of the sectoral collective agreements and of autonomous collective bargaining, rather than of any lack of uniformity in the area of temporary agency work.

Like most other 'old' EU countries, but in contrast to its neighbour Sweden, Denmark introduced a set of transitional rules on 1st May 2004 concerning immigration from the new Member States. A majority in the Parliament and the social

partners supported the rules, which were aimed at protecting the balance of the labour market as well as protecting the social welfare system against 'social tourism' from Eastern Europe. As Denmark has no national minimum wage defined by law or by collective bargaining, the initiative also aimed to support the existing collective agreement system, in broad terms called the Danish Model, where wages are agreed at sectoral level and company level.

According to the transitional law, workers from Central and Eastern European countries can only obtain a work and residence permit if the work to be done is a full-time job paid according to a collective agreement. A number of public authorities including the tax authorities, the police, the Danish Immigration Service (Udlændingestyrelsen) and the Regional Labour Market Councils (De Regionale Arbejdsmarkedsråd, RAR), which includes representation of the social partners, monitor the observance of the rules, and a monitoring committee was set up in cooperation with social partners at national level.

The law on posted workers provides that workers posted from other EU countries work under the same conditions as Danish workers.

## Nature and features of undeclared labour

### Definition

Undeclared labour is defined as non-registered productive activities that are not reported and taxed according to existing legislation. It has been relatively widespread in Denmark since income tax was introduced in 1903. Undeclared activities are illegal because they fail to comply with the mandatory reporting requirements to tax authorities, whether for VAT or for income tax. Undeclared activities are mainly found in the provision of personal services to families, friends and colleagues, and in work in restaurants, retail, cleaning, construction, agriculture and horticulture. Although accurate data are not available, it appears that 'domestic' undeclared labour (that is, performed for householders) may be skilled or unskilled, and is more likely to involve men in construction work and women in cleaning and childcare. The more 'commercial' undeclared labour in the other sectors listed above is performed in many cases by students (in all sectors, but especially in restaurants), and migrant workers from Turkey, the Middle East, Pakistan and Somalia (often in retail, cleaning and catering) or from the new Member States in CEE (notably in construction and agriculture). The unemployment rates of migrants living permanently in Denmark have always been notably higher compared to the total labour force. Unreported activities performed by immigrants without a work permit are defined as illegal labour.

### Different forms

The issue of increasing 'bogus' self-employment is seen as a problem by the main construction industry employers' organisation, the Danish Construction Association. Out of the 11,000 one-person companies in building and construction, only half are considered by both trade unions and employers to be genuinely self-employed.



The social partners in construction have agreed to monitor workplaces, as far as possible, and report any cases where the employer cannot account for workers at the workplace. Local branches have been asked to be 'on the alert'. As far as the functioning of the restrictions of the transitional scheme after EU-enlargement is concerned, several examples were cited by the BAT cartel.

Many citizens from CEE countries work in the sector as bogus self-employed workers. They are working for only one employer, who also provides tools and materials, or as temporary agency workers, or for a company for instance in Poland, which provides workers for a contract in Denmark under the provisions of the law for posted workers. In these cases the Danish collective agreements are not in force or at least the coverage is blurred, as in case of the temporary agency workers. This grey zone covers persons who are working illegally (under cover of being posted) and persons who claim to fulfil the right of company establishment inside the EU. Although a manual has been produced for all parties involved (employers, unions, police) to make the rules more transparent and result oriented, it is still difficult to determine in which cases the law has been broken. As one union leader from BAT has said: "We have to check if posted workers from companies in Poland and so on fulfil the terms of the law or if in reality they are hired by the company in Denmark. In this case we can demand that the company sign an adoption agreement or otherwise legally boycott the company. It is difficult. We have to do what they did in the infancy of the trade unions. We have to go out there and sign and defend collective agreements."

## Extent

According to Gunnar Viby Mogensen (Danmarks uformelle økonomi – historiske og internationale aspekter, 2003), undeclared labour represented some 3.8% of GDP in 2001, and this level had fluctuated over previous years: see Table 1 below.

The government launched an inspection campaign in April 2004 against undeclared work in restaurants and pizzerias, kiosks, taxi driving, agriculture and gardening, markets, nightclubs, newspaper distribution, massage parlours and bakeries. The campaign involved a partnership between different ministries and public authorities, with the social partners and trade associations also participating.

Table 2 shows that failure to declare labour, whether because of unsatisfactory accounts or undeclared labour proper, is quite substantial. Almost all pizzerias and kiosks are owned and staffed by immigrants from countries outside Europe. Overall, it could be concluded that 45.6% of the workers inspected in June 2004 were performing undeclared work, since their employment was not known to the tax authorities, with those supposedly working their first day accounting for a substantial part of the problem.

Construction was not a target group of that initial campaign. Later on the construction sector became more and more involved. Activities of the trade unions (primary boycott and secondary

*Table 1: Undeclared labour as % of GDP*

1988	1991	1994	1996	2001
2.5%	4.4%	3.4%	2.6%	3.8%

Source: Viby Mogensen 2003, quoted in the Thematic Feature – industrial relations and undeclared work, EIRO, 2004.

Table 2: Findings of undeclared labour inspections carried out by tax authorities, 3-13 June 2004

	Companies inspected	Companies with unsatisfactory accounts	Workers in companies inspected	Workers listed in MIA*	Workers said to be on first day at work	Workers receiving unemployment benefit	Workers receiving social benefit
Pizzerias, restaurants	678	40.7% (276)	1,846	45.4% (839)	18% (332)	7.4% (136)	10.1% (186)
Others	1,099	24.7% (271)	2,271	61.7% (1,401)	6.6% (149)	2.8% (64)	5.1% (116)
Total	1,767	31.7% (547)	4,117	54.4% (2,240)	11.1% (481)	4.9% (200)	7.3% (302)

Source: Ministry of Taxation.

\* New employees have to be registered within the first month of employment in an establishment in the Monthly Report on Employees (Månedlig Indberetning af Ansatte, MIA). Thus if the workers inspected in June 2004 were claimed to be on their first day at work at the establishment, this could not be verified by the authorities.

sympathy actions), aiming to force foreign companies to comply with the bargaining tradition contributed to this stronger involvement. These activities received widespread attention in the media. The fact that the labour market partners in the industry could come to joint positions in this field also brought more attention to the phenomenon.

It seems that the transitional laws for workers from CEE countries have worked, in so far as the expected and feared 'invasion' of cheap labour has not taken place. An overview of the Immigration Service (dated the end of March 2005, so almost one year after enlargement) reported that there were 1,931 active work permits. The difference between permits given and active permits is due to the fact that a number of the Eastern European citizens with a legal permit at the calculation date either had finished their work or had not started yet. The active permits are divided among the following sectors (March 2005).

Sector	Number of Persons	Change since Feb. 2005
Agriculture and gardening	838	+153
Industry	165	+12
Building and construction	172	+26
Retail, hotel and restaurant	135	+11
Transport	54	+4
Finance	98	+22
Public and personal services	375	+77
No data	94	+43
Total	1,931	+348

The majority of the permits were given to citizens from Poland (809), Lithuania (685) and Latvia (191). As of April 2005 the Immigration Service had received 5,167 applications for a work and residence permit from citizens in the new Eastern EU-countries. According to the provisions of the law the permits given were divided as follows:

- 64 % were covered by a collective agreement at the company;
- 10 % were given to researchers and professionals on individual contracts;
- 26 % of the permits were given to workers in companies covered by an adoption agreement.

By the end of August 2005, a total number of 5,472 workers, mainly from Poland and the Baltic countries, had been granted a work permit in accordance with the rules laid down in the transitional scheme. About 4,000 were active while the remaining permits had either expired or had not yet taken effect. The report thus drew the conclusion that the total number of work permits must be said to be rather modest. Half of the active permits were given in agriculture and horticulture (corresponding to 5 % of the total workforce in this sector), while 7.1 % of all permits were given in the construction sector. By August there were 285 active work permits in this sector. The number of posted workers and of persons that have chosen to establish a company in Denmark is rather blurred, but does not exceed a couple of hundred.

In construction, attempts to circumvent the rules are mainly found in the establishment of bogus one-person companies where the alleged self-employed person is actually in an employee relationship as he/she receives all instructions and working tools from the alleged customer. The number of reports to the police about such illegal labour and the number of charges and court decisions increased from 2004 to 2005.

But all in all the invasion did not take place, and the authorities' estimation of the situation is that the law has had a positive effect. Still, the success depends on the eyes of the beholder. The unions in building and construction in particular, represented by the cooperation cartel, the Building, Construction and Wood Industry Cartel (Bygge-, Anlægs- og Trækartellet, BAT) continue to point to the pitfalls within the law. Since 1st May 2004 the BAT cartel has reported 177 cases of illegal labour to the police covering 710 citizens from Eastern Europe.

## Functioning of the undeclared labour market

### Actors

The shadow economy consists of unreported productive economic activities and tax evasion. In many cases both the seller and the buyer of goods or services are aware of the character of the transaction. Within the different occupational groups, unskilled and skilled workers are frequently present, closely followed by the self-employed. The unemployed are not overrepresented. Several authors suggest that it is more difficult to get access to potential customers as soon as you are no longer part of the formal labour market. What is more, the unemployed have less possibility to 'borrow' tools and equipment from their regular employer for the undeclared labour outside the standard working hours.

A typical person active in undeclared labour is a young semi-skilled male, combining a full-time job in construction with non-reported activities. The highest payments for undeclared labour are made to self-employed and salaried workers.

Campaigns in Denmark against undeclared labour go hand in hand with the campaign against illegal labour, and illegal labour is often connected to immigration. However, public debate has a tendency to exaggerate the role of the immigrants in undeclared labour. Undeclared labour has existed since income tax was introduced a century ago and, while being quite widespread, it does not appear to have grown in any very significant way. In recent decades undeclared labour has involved immigrants to a considerable degree, and the current campaign against undeclared labour is concentrated on sectors with a relatively high share of immigrant workers.

In addition to the increase in the number of one-person companies, a key reason why the trade unions in the construction industry have launched new initiatives is the view that most one-person companies are in fact bogus self-employed people ('falske selvstændige'), whether they have been asked to work as such or it is their own free choice. Their existence is seen as constituting a threat to collective agreements as long as the employers find it profitable to recruit such false self-employed workers. Examples have been reported of construction workers working under a collective agreement who have been encouraged or even intimidated by their employer to obtain a VAT number to provide evidence of their registration as self-employed. However, despite the change in the worker's formal status, it is still the same employer that deals with orders, materials and tools and organises the work.

During 2004, the government and the social partners made a great effort to tackle undeclared labour. Cooperation on this issue took place between police, government agencies, ministries, employers' associations, employers' trade organisations and trade unions. A number of illegal workers, in particular from CEE countries, Turkey and Middle Eastern countries, were found to be working in hotels and restaurants, in pizzerias, in kiosks and in the construction sector. Critics claimed that the police raids were concentrated in areas and sectors mainly populated by people with a non-Danish ethnic background, whereas undeclared labour in private homes, which has existed since the introduction of income tax in 1903, was not inspected in this way.

## Reasons

Since the introduction of income tax at the beginning of the 20th century, tax evasion through undeclared labour has been relatively widespread in Denmark. Initially, this was mainly in the construction sector, but undeclared labour later spread to restaurants and shops, and was combined in many cases with other forms of tax fraud.

The high level of income taxation and VAT rates might act as a stimulus to undeclared labour. By international comparison, however, undeclared labour seems to stay relatively low except for the undeclared activities undertaken by salaried and self-employed workers that have already a regular earning in the formal part of the market.

## Dynamics

There is currently a heightened awareness among workers as well as in the general public about undeclared and illegal labour. Partly this is because of the enlargement of the EU in 1st May 2004, which triggered many debates about possible illegal

workers coming from the new Member States. In this context, construction and agriculture trade unions (and employers' associations to a certain degree) have called on the authorities to introduce rules to prevent undeclared and illegal labour.

As to the latest predictions of the number of Polish workers coming to Denmark, it seems that new figures are being produced every week on the numbers of workers due to arrive from the new Member States. The divergence between the figures is great, and the best course would be to monitor the situation and see what actually happens. The trade unions' aim is to monitor intensely the situation in Danish workplaces and ensure that every worker from CEE countries has a work permit.

The National Labour Market Authority (Arbejdsmarkedsstyrelsen) has estimated that the accession of workers from CEE countries has not had a great effect on the labour market. However, according to the labour market authority, the effect seems positive in agriculture and gardening where persons from CEE countries cover a large part of the demand for work that would otherwise be difficult to fulfil. Per Konghøj Madsen, professor of labour market studies, has opposed this viewpoint and argues that the influx of workers from Eastern Europe will put a pressure on wages and the union density in the building and construction sector, as it is happening in Germany.

It is also said that workers who have come since the enlargement of the European Union in May 2004 have contributed to counteracting the emergence of bottlenecks in the labour market – in particular in agriculture and horticulture and in the construction sector. This is one of the results of a report published by the Ministry of Employment in November 2005. That report recommended that new initiatives should be considered with a view to attracting highly skilled experts and researchers as well as skilled workers in construction. It also recommended examining the possibilities for relaxing the rules as laid down in the transitional scheme.

Recent figures (Rockwool, April 2006) indicate a decrease in the extent of undeclared labour in construction. The authors see various reasons for this decrease. First, the prospects of the construction labour market have improved – currently there is a high demand for labour, and this is expected to continue for some years to come in the official, declared part of the market. Labour shortages have an upward effect on wages and probably lead to more direct employment. On the other hand the costs of and hourly payments asked for undeclared labour have increased sharply.

Secondly the decrease may be a result of the Fairplay campaign set up by the government with construction as one of the focus sectors.

No recent reliable figures are available; earlier estimates (2001) were that up to 25 % of the hours worked in construction were undeclared.

## Effects

The first effect of undeclared labour is that it limits the tax base because of lower revenues. At the end of the 20th century the annual shortfall in state tax revenues due to undeclared labour was estimated to be DKK 25 billion (€3.3 billion), though the extent of undeclared labour was thought to be declining. If this led to higher taxation, undeclared labour could become even more popular. At the moment undeclared activities are seen as an 'extra' income next to the decent, regular earning. A

development of more systematic tax fraud would be a serious threat to the existing socio-economic system.

Secondly, the legitimacy of the labour market organisations could be at stake. The labour market model is based on strong social partnerships with autonomous employers' organisations and trade unions that jointly 'rule' the market. Systematic fraud and undeclared activity would undermine this pillar of market regulation.

Thirdly, undeclared labour represents a substantial parallel economy damaging the competitiveness of small enterprises and resulting in increased taxation on them, according to the Danish Federation of Small and Medium-Sized Enterprises (HVR). In this connection, HVR proposes a lower VAT rate on services and a lower minimum turnover above which companies must register for VAT. Both trade unions and employers' organisations have raised the possibility of excluding members that carry out undeclared work.

## Measures

In 2003, at the behest of parliament, the national police were asked to draw up an action plan to combat illegal and undeclared labour. Innovatively, the plan involved a wide range of different authorities, along with the social partners, in a cooperative effort to combat crime in this area. Public authorities such as the police, the public prosecutor, the Immigration Service, the Customs and Tax Authority and the Public Employment Service met representatives of trade unions and employers' organisations to discuss possible initiatives in this field. The result was the creation of regional networks, with the local branches of trade unions playing a major role in the detection of illegal workers at workplaces, and employers' organisations helping in particular to identify the ringleaders who organise the illegal workers and the employers that hire them. So far, the campaign has been successful in uncovering the scope of undeclared labour and tax evasion.

In December 2003, the Danish parliament approved measures aimed at preventing illegal labour and possible misuse of the Danish welfare system when workers from CEE countries sought jobs in Denmark following EU enlargement on 1st May 2004. Under transitional arrangements agreed by the EU and new Member States, which joined on 1st May 2004, the existing Member States may limit movements of workers from the new Member States for a period of up to seven years after enlargement. A majority in the Danish parliament (Folketinget) supported a government proposal to introduce such transitional limitations. Thus Denmark joined the other 'old' Member States, with the exception of Ireland, in taking a number of precautions in order to prevent an excessive movement of workers from the east. According to the measures, citizens from the new EU Member States could seek work in Denmark on the same footing as other EU nationals from 1st May 2004. However, they have no right to receive social benefits while searching for a job. If they find a job they have to apply – unlike other EU nationals – for a special work and residence permit, which is granted only if they have a full-time job on terms corresponding to those normally applying on the Danish labour market. This means that no permit is

granted for part-time work or work at a wage which is lower than that laid down in collective agreements. This means that workers coming from, for example, Poland or the Baltic states – the nationalities most likely to seek work – do not have any right to Danish social provisions such as unemployment benefit. If they are unable to find a job or are dismissed, they lose their residence permit and have to leave.

It has been claimed that there are possibilities to circumvent the new provisions and for workers from CEE countries to take a job at a wage lower than the relevant collectively agreed rate. The umbrella organisation of trade unions in the building and construction industry (Bygnings-, Anlægs, and Trækartellet or BAT) criticised the government for seeking to pass transitional measures, describing these measures as ‘full of holes’. The criticism resulted from a number of cases. A Danish entrepreneur had set up a company in Poland through which he was offering to provide construction work carried out by Polish workers at half the cost of Danish workers. Another example was a Polish company offering to install kitchens and bathrooms for a price that was 50% lower than Danish companies. In both cases, BAT claimed that these moves were possible under the Danish legislation implementing the 1996 EU Directive concerning the posting of workers in the framework of the provision of services. The transitional scheme applies only where workers from, for example, Poland are hired by a Danish company. But wants to have the rules of the transitional scheme to be applicable to every worker from the CEE countries.

According to Denmark’s 2003 National Action Plan on employment, it is government policy to make it easier in administrative terms to comply with the relevant legislation – including that on the establishment and operation of enterprises – and thus address an important barrier to transforming undeclared labour into regular employment. Under a recent ‘competition package’, a number of statutory rules and regulations have been abolished, and obligations to submit reports and data to public authorities have been simplified. The package also comprises a number of tax relief measures, such as higher income limits for VAT registration and extension of a special business set-up account scheme. HVR has proposed additional measures, including criminalisation of the employers of undeclared labour and a lower VAT rate on services.

The unions wanted the tax authorities to intensify their controls of one-person companies and the companies which employ them, and in August 2003 they approached the construction industry organisation, Bygherreforeningen i Danmark, and asked it to take measures to prevent member companies from hiring bogus self-employed people.

In 2003-04, the public labour market and tax authorities, the police, the social partners and to a certain degree the Danish Immigration Service campaigned against undeclared labour in shops, catering, and construction.

In June 2004, the Ministry of Taxation launched a campaign against undeclared labour. The campaign was aimed at employers, and trade unions in construction are to do the same. This was followed in the same year by the Fairplay campaign consisting of advertisements and control activities focusing on the fact that undeclared labour isn’t fair and can be punished. Construction was an important target group during this campaign.

## Good practices

The social partners support the various initiatives taken by the authorities, including practical support as far as possible. They agree that undeclared labour is a violation of, and a threat to, the Danish collective bargaining system, which regulates most labour market issues.

On the trade union side, it is especially the Danish Union of Wood, Industrial and Construction Workers (or TIB) and SiD which are involved. The cartel in building and construction (BAT-kartellet) is coordinating the unions' efforts. In summer 2003, the TIB announced plans to set up an affiliated organisation that will offer membership to self-employed people in the construction sector. This initiative is targeted at people working as self-employed under questionable circumstances, usually receiving lower pay than set by collective agreements. One-person companies do not meet the conditions to be considered as companies, as all they provide is their own labour ('arme og ben-firmaer' or 'arms and legs firms'). The unions are aiming to combat this phenomenon, both through unionising the more 'serious' of the self-employed one-person companies and closing down the less serious ones.

TIB's plan for an affiliated organisation that organises self-employed people is the first of its type in Denmark. In principle it should be possible, as there seems to be no major overlap between the one-person companies who are members of an employers' organisation and those who are merely one-person 'arms and legs firms'. Given the strong growth of various forms of 'atypical' employment across Europe, the establishment of a trade union for the self-employed may be less self-contradictory than it might appear. There is a very delicate borderline between one-person companies, free agents, casual workers, freelancers and bogus self-employed people. The common feature is that they are all forms of atypical employment and that there is major growth in such employment.



# Finland<sup>11</sup>

## Regulation and institutions

### The legal framework

In 2002 some changes were made to the Penal Code in order to strengthen the fight against economic fraud. Further legislative changes were made to the Penal Code, the Employment Contracts Act and the Aliens Act during 2004. These legislative changes relate closely to the use of foreign workers and, to some extent, to undeclared labour.

Section 6a of Paragraph 47 of the Penal Code has also been amended. Now, an employer or its representative that hires or employs a foreign national not in possession of the requisite work permit is guilty of the use of illicit foreign labour and liable to a fine or imprisonment for up to one year.

Section 16 of Chapter 11 of the Employment Contracts Act prescribes the right of employees to receive a payslip. An employer or its representative that fails, on request, to provide a payslip to an employee is liable to a fine for violation of the Act.

According to Paragraph 73 of the revised Aliens Act (301/2004), an employer that hires an employee from a third country must, without any delay, report this to an employment office and also inform the workplace shop steward and industrial safety delegate about the recruitment of the foreign worker and the collective agreement that applies.

In April 2006, the Finnish government reached a settlement with both sides of industry regarding new legislation on subscriber liability. This settlement outlines the matters that a company must investigate when using outside labour. The aim is to ensure that subcontractors and employment agencies discharge their obligations and

<sup>11</sup> The basic country report was written by Jan Cremers, European Institute for Construction Labour Research, Utrecht, The Netherlands. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

comply with minimum employment terms. Under the proposed subscriber liability law, a company that uses outside labour will have to investigate whether any subcontractor or employment agency that it uses is registered in Finland for withholding income tax, employment and value-added tax purposes. Documentation such as an extract from the trade register and a certificate of clearance for tax payments and employment pension contributions will also be required. The investigation will likewise cover details of the applicable collective agreement or of the principal terms and conditions of employment.

Corresponding information will also be required for foreign enterprises. However, there will be no duty to investigate the operations of established subcontractors and employment agencies or of national or local public authorities, public limited companies, state commercial institutions or organisations of comparable standing. A partner may be considered established, for example, when it has engaged in substantial business operations for about three years.

The new subscriber liability legislation will also include a provision requiring the subscribing company to notify its shop steward and labour protection delegate of any agreement on the use of outside labour. This notification will have to give details such as the amount of labour to be used, the length of the agreement and the applicable collective agreement or principal terms and conditions of employment.

The new law will apply whenever agency workers are used for longer than a total of 10 working days, or if the value of a subcontracting agreement exceeds €7,500. A subscriber enterprise that fails to investigate the circumstances of its partner will be liable for a penalty fine of between €1,500 and €15,000. The local labour protection authority will determine this fine. The Finnish government will seek to introduce subscriber liability legislation before the end of the year.

Finland has a legal mechanism for extending collective agreements to make these agreements generally applicable. According to the Collective Agreements Act a collective agreement is defined as any agreement concluded by one or more employers or registered associations of employers and one or more registered trade unions, concerning the conditions to be complied with in contracts of employment or in employment more in general. The agreement is binding upon the signatory parties, registered associations that are subordinated directly or through one or more intermediaries to the signatory parties and individual employers and employees who are members of these associations. A contractor has to observe the provisions of the national collective agreement for construction that is normally made generally applicable with a national coverage. The agreement defines the terms and working conditions of the employment relationship. It stipulates the minimum rate of pay that an employer has to pay for a certain work or to an employee in a certain category. The agreement applies also to a posted construction worker.

### Authorities or institutions involved

Institutions involved are the custom and tax authorities, the police and trade associations. As part of the National Action Plan, the government wants to promote cooperation between the authorities and to rectify shortcomings in the legislation.

The aim is to make monitoring easier and to increase information provision to foreign workers.

Social partners have established a strong cooperation with labour protection officials, the tax administration, the police and custom offices. The problem is poor staffing, weak control rights and few resources. Unions and employer organisations are striving for regulations in collective agreements, and the government is also involved.

However, a majority of employers are not organised and therefore the position of the employers' organisations is relatively weak. Arrangements between the social partners are only effectively covered by organised companies, leaving the unorganised out. Notwithstanding this fact there have been joint initiatives on better information provision and on training of shop stewards and employees. The construction social partners have been cooperating for a long time to curb undeclared labour in their sector. This cooperation has resulted in an agreement on procedures to curb such practices, whereby: companies demand proof of payment of tax liabilities and pension contributions from prospective contractors when they call for tenders; information on contracts is delivered quarterly to the tax administration; and electronic access pass systems are used by workers at building sites. The social partners have also jointly written a guide on how to use foreign labour in the construction sector. The Finnish Construction Trade Union (Rakennusliitto) has unilaterally conducted inspections of building sites to gather details of outsourced operations and their adherence to collective agreements.

## Nature and features of undeclared labour

### Definition

At first glance Finland belongs to the countries with a rather narrow legislative definition applied to undeclared labour. There was and is a first limitation to any labour not declared to tax authorities. The consequence is that taxes and social security fees not paid build the main condition for labour to be qualified as illegal. Non-compliance with the generally binding collective agreements is unlawful but is not seen as undeclared labour.

A second category is any form of 'exploitative' labour discrimination. A new Section 3a dealing with exploitative labour discrimination has been added (in 2004) to Paragraph 47 of the Penal Code. According to this Section, if employees are put in an inferior position by an employer taking advantage of their financial or other distress, position of dependence or lack of understanding, or the thoughtlessness of another, the employer or its representative is liable to a fine or to imprisonment for up to two years. It is unclear whether there has been any case law in this field.

### Extent

Early estimates on the overall size place Finland in the category of countries with a rather modest level of undeclared activities (4.2% of GDP in 1992). Later on it was estimated that the share of the black economy had remained at the 1992 levels.

In construction, informal economic activity has been estimated as representing (in 1998) between 9% and 16% of the industry's production, which corresponds to between 17,000 and 23,000 person-years (the annual labour of 17,000-23,000 people). Recent estimates (in 2005) calculate that the shadow economy accounts for around 11% of the Finnish construction industry, generating a sum of €700 million, and with a cost to society of €200 million in lost tax revenue.

There are no estimates of the overall involvement of legal or illegal immigrants, though recent discussions have paid increasing attention to the challenges with regard to the informal economy which have been raised by the eastwards enlargement of the EU in May 2004. The question of provision of services and free movement of workers has drawn much attention: there are hundreds of (Finnish) companies with establishments in Estonia (after 1st May 2004) and an increasing activity of temporary agency workers. Since then, the avoidance of social dumping and the protection of posted workers have become important issues. Compliance with the construction collective agreement that is rendered applicable to all employees is in the forefront of the political debate. The Finnish Construction Trade Union suspects that only half of the sector's estimated 9,000-10,000 foreign workers are working legally. The employers so far have not given an estimate of the number of illegal workers. The employers' organisation in the sector, the Confederation of Finnish Construction Industries (Rakennusteollisuus, or RT), however, puts the number of foreign nationals working legally substantially lower than Rakennusliitto's estimate.

Recent inspections in southern Finland found 20% of construction companies with foreign employees lacked proper documentation of their work permits or citizenship. Labour inspectors say the actual situation is probably much worse, because the companies they looked into were well-known outfits. Smaller, less visible companies are more likely to rely on illegal labour.

The industry is criticized for using cheap illegal labour and sometimes circumventing stringent Finnish labour laws. Illegal workers – especially from the Baltic States and Russia but from as far away as China – frequently slip into the system. Most of these employees work under substandard contracts with few benefits. Latest inspections revealed that a fifth of construction companies couldn't guarantee that all of their foreign labour was above-board.

Another phenomenon has been the increase in self-employment. To a certain extent, self-employment is also associated with undeclared labour. At the level of the whole economy, the scope of the problem is likely to be rather small, but in construction the phenomenon is certainly more widespread. The first trend towards more self-employment (outside agriculture) started in the early 1990s (see Table 1). From that moment, self-employment was seen by respective governments as an integral part of the labour market reform and as an alternative for unemployment. In the Labour Policy Strategy 2003-2007-2010, as adopted on the 23rd October 2003, the increase of self-employment was one of the five strategic principles. Finally in the National Action Plan for Employment 2004 self-employment was, in accordance with the EU's employment guidelines, embraced as part of the development strategy towards entrepreneurship. In recent figures it is said that some 40% of all undertakings (overall) are single-person enterprises.

*Table 1: Self-employment as a percentage of total employment by industry, 1989, 1993 and 1997*

Industry	1989	1993	1997
Agriculture, forestry, fishing	65	64	67
Manufacturing, mining, quarrying, energy supply	5	6	6
Construction	16	19	19
Retail, repair of vehicles and household goods	17	18	20
Hotels and restaurants	13	17	14
Transport, storage and communication	12	13	14
Financial, real estate, business services	11	13	13
Education, health care and social work	3	2	2
Personal services and other community services	19	22	20
All non-agricultural industries	9	10	10
All industries	14	15	14

Source: Statistics Finland Labour Force Survey.

## Functioning of the undeclared labour market

### Actors

Following EU enlargement in 2004 the issue of temporary agencies has become more marked as nationals of the new Member States have had free access to the Finnish labour market through agencies while those looking for work independently still need work permits. Agency work is on the rise as a result of the activities of foreign agencies, and actually – to even a larger extent – of Finnish agencies. These agencies often do not comply with collective agreements and create widespread problems with undeclared work. Most of the foreign agencies are based in the Baltic States and especially in Estonia. A large proportion of Estonian agencies are actually owned by Finns, and a survey executed by the Finnish Construction Trade Union during a period of seven months in 2004 showed that, of the 21 Estonian based companies, 10 were owned or founded by Finns.

Industrial disputes have taken place in situations where there has been disagreement about foreign workers' work permits or the appropriateness of their working conditions. There are also cases where the target of action on the issue of undeclared labour has been a specific company, and cooperation has involved the police and/or tax authorities. In 2005 alone the construction union initiated 50 industrial actions against undeclared practices with foreign labour.

The high tax wedge has contributed to tax evasion or unjustified claims for social benefits filed by people working clandestinely. In early estimates (1994) it has been calculated that some 3 to 4 % of the recipients of unemployment benefits work on the black market. According to several surveys, the unemployed do not work in the black economy more than the employed. The black economy is assumed to be bigger in absolute terms during periods of high economic activity and is also thought to reflect the effect of better opportunities. In terms of capabilities and contacts, a better education and a higher level of income seem to be positively related to a high

incidence of undeclared labour. Finally, according to a survey commissioned by the National Board of Taxes in 1996, 16% of the respondents reported that they had carried out undeclared labour during the preceding year. Moreover, 19% of the respondents said that during the preceding five years, they had bought goods or services on which statutory dues had not been paid.

Construction is an important sector with 6.5% share of total employment and 5.4% of value-added to the total economy (2002). Both building and civil engineering recovered in 2003 after a period of recession. Reports talk about booming business as economic indicators are currently very good with a rising demand in construction products. Employment figures are expected to improve throughout 2006. In construction, labour shortages are predicted. Shortages of skilled labour are considered an obstacle to production increases while contractors indicate that they are operating at full capacity. However, in some subsectors structural changes are still causing job losses. Employment in construction was estimated in 2005 at 153,000 workers (118,000 building, 35,000 civil engineering) and output went up to €20.1 billion.

According to recent figures the industry is dominated by small and medium-sized enterprises (with an average of four workers). Bigger contractors are coming from outside (as for instance Skanska or NCC). Finnish construction always had the highest research and development input, partially caused by the climate conditions.

## Segments

The bulk of the informal economic activity in the construction industry takes place in the chains of subcontractors on large building sites. It has reportedly become common practice for these companies to forge receipts and outsourcing contracts in order not to disclose the true amount of labour provided at their sites. This allows them to pay part of the wages illicitly. By setting up a new company with a clean record, breaches of tax and pension contribution payments can be hidden easily. It is very easy to establish a new company and this is common in the construction industry.

Undeclared labour in construction is strongly male-dominated. Although the majority of the illegal workers in construction are Finnish nationals, growing numbers of foreign workers are entering the shadow labour market. Nowadays, the general feeling is that illegal foreign work is the dominant shape of undeclared labour.

## Dynamics

Notwithstanding the modest figures, according to several authors, undeclared labour is on the rise in Finland with construction on top of the list of sectors concerned. Applicable legislation (taxation, social security, labour legislation) has been recently revised and increased cooperation of authorities is announced.

According to the Labour Force Survey of Statistics, the number of both wage earners and self-employed persons grew during the period 2005-2006. Employment increased in manufacturing, construction, transport and social services. Official data show only a slight increase of self-employment and in the overall figures (all industries) self-employment stabilises at the level of the 1990s (Table 2).

Table 2: Changes in the labour force 2005-2006 (in thousands)

	Jan. 2006	Jan. 2005	Change 1/05-1/06
Employed total	2 353	2 299	2.3 %
- wage and salary earners	2 034	1 995	2.0 %
- self-employed and assisting family members	318	304	4.8 %
Employment rate	66.6 %	65.3 %	1.3 %
Unemployed *	226	249	-9.3 %
Unemployment rate	8.7 %	9.8 %	-1.1 %
Labour force, total	2 578	2 547	1.2 %
Labour force participation rate	65.2 %	64.6 %	0.6 %
Economically inactive, total	1 377	1 394	-1.2 %
- students	372	394	-5.4 %
- persons performing domestic work	87	93	-6.6 %
- economically inactive persons in disguised unemployment	114	96	18.3 %

Source: Statistics Finland's Labour Force Survey.

\* Based on the recommendations of the International Labour Organisation (ILO)

## Effects

The social partners agree that undeclared labour is creating a distortion of competition and has negative socio-economic effects. Undeclared labour puts pressure on social provisions and benefits and it has an undermining effect on industry wide provisions.

Transactions in the shadow, rather than the official, economy keep state revenues lower than they otherwise would be, and in turn reduce government's ability to provide goods and services. Higher taxation, especially when combined with a perceived deterioration in the quality of public goods and administration, is a strong motivation to move into the shadow economy, thus perpetuating the cycle.

The general impression is that there is less acceptance to earn income without paying taxes than in the 1990s, according to an opinion poll of SAK.

In recent years the enforcement policy of increased control by tax and labour market authorities has been combined with increasing public attention for an efficient monitoring of the working conditions of foreign workers. This policy is developed with a view on the mix of shaping factors, different actors and circumstances, and the effects of undeclared labour. The acceptance in society of this range of institutional arrangements is growing.

## Measures

The interest in the prevention of undeclared labour stems from the 1990s when there was a deep recession. Concern about the negative effects of the informal economy on society was a starting point for several government programmes for the prevention of black economy and economic crime. The first programme (in 1996) included measures

to increase surveillance and sanctions, as well as research and information campaigns. The focus was on preventative measures and reduction of opportunities to commit economic crimes. The aim was to minimise the damages that economic crimes can cause and to prevent harmful practices that have a negative effect on public financing. The undeclared economy was defined in fiscal terms.

Both trade unions and employers' organisations regard undeclared labour as a cause of concern. Trade unions have taken part in all nationwide activities against undeclared labour (see above), and have taken an active role at the local level. In the context of EU enlargement, trade unions have demanded a right to institute, without their authorisation, legal proceedings on behalf of foreign workers posted to Finland, with regard to their wages and other terms of employment.

Employers emphasise that the most important point in this respect is to combat criminal activities and to carry out measures that prevent deliberate law breaking. Employers are not in favour of measures that increase bureaucracy and make regular companies' operations more difficult.

Besides subscriber liability, mentioned above, the social partners are also seeking to combat the shadow economy by such methods as extending taxation and supervision of foreign agency labour, requiring foreign enterprises to be listed in the tax withholding register and securing the permanent status of the foreign labour surveillance unit at the Finnish National Bureau of Investigation.

Finally they cooperate in campaigns in the industry and in informing construction companies about the proper use of foreign labour. In May 2004, they published a guidebook on the subject.

As of May 1st 2006, Finland will no longer restrict the free movement of labour from the new Member States of the EU. The past two years of restricted entry rights have been put to good use by allowing time for control mechanisms against the shadow economy and abuse of foreign labour to be put firmly in place. The core of the new legislation will be the subscriber liability law mentioned before. Labour market parties and the Finnish government have reached an agreement on what exactly this should cover. Companies will have more obligations to investigate their subcontractors' ways of handling taxation and social security payments and the working conditions of subcontractor employees. New legislation on taxation of foreign labour sent by agencies, based outside of Finland, is also underway. Under current Finnish legislation, Finland cannot tax foreign agency labour that works in Finland for a period of less than six months. However, treaties with other Nordic countries and the Baltic States allow to tax foreign agency labour for even short periods of work in Finland. The government wants to tighten control over foreign agency labour. It will require all foreign employees coming from other EU Member States to register at an employment bureau within two weeks of arrival.

In the present EU it is fully possible for an undertaker condemned by court to a prohibition to conduct any business by reasons of grave misconduct to establish himself in another country and conduct activities as services provider by use of posted workers in the Member State where the prohibition is in force. In order to tackle this problem the government introduced legislation prescribing a requirement of a legal representative.



## Good practices

The electronic pass system and the requirements for disclosure of company information probably contribute to a reduction of illicit activities. For this, the monitoring of company activities not only has to be made more extensive but also needs to take place in electronic form and as close to real time as possible. At present the informal economy is always one step ahead of the supervisory agencies and successful raids on building sites require good timing and large personnel resources. A further step in the right direction has been the tax administration's online and SMS service, which allows any company's prepayment registration status to be checked in real time. This used to be done by making companies provide a printout certificate, and these were frequently forgeries.

According to a recent report by the public authorities, assessing the state of the clandestine economy in Finland, the electronic pass system has proved the most effective of the measures in the construction industry. It has made it possible effectively to monitor all contractors and workers at building sites. As a result, illicit activity is now easier to detect.

Other agreed measures have been less successful. It is still very easy to start a new company with a clean record in construction and hide breaches of tax and pension contribution payments.

Since 1st February 2006, employees on construction sites have to wear visible identifiers. This is decreed in a new provision of the 2002 Occupational Safety and Health Act. The only people exempt from this ruling are those transporting goods to the sites. Identifiers must also be worn on sites where old buildings are undergoing renovation. The identifier has to include its holder's photograph, name and his or her employer's name.

The Construction Trade Union regards the reform as an important step in the fight against the shadow economy and illegal employment. It will also improve occupational safety, the union emphasises. The Union has itself decided to increase the resources it spends on monitoring construction sites. Monitoring usage of identifiers will be one of the new challenges. An open question is how to tackle fake identifiers that eventually will be used by some of those involved in illegal activities. According to the new order, those responsible for neglect against it may be fined.

# France<sup>12</sup>

## Regulation and institutions

### Statutory and Collective Regulation of Labour Relations

French labour law is drawn up on four levels, whereby the requirements of the Labour Code are attributed the greatest importance. In addition, in some areas there are inter-professional collective agreements, which assume a statutory nature. Examples of this are the conventions for professional training. At a third level there are the sectoral agreements to be negotiated by the trade unions and employers' federations. Among other things it is prescribed by law that the sectoral negotiations are to be carried on at regular intervals. For example, wage bargaining is to be conducted annually. Collective agreements may also be made at company level. Here the Labour Code also prescribes intervals between negotiations (among other things regarding wages), provided there are trade union delegates in the company. The order of precedence for regulations in the Labour Code provide that sectoral collective agreements have to be more favourable than the statutory regulations, and the company agreement more favourable than the sectoral collective agreement. The great influence of the State on the collective regulation of labour relations, particularly if compared to the voluntary Anglo-Saxon tradition of free collective bargaining, is apparent in its role as initiator and moderator in collective bargaining, as well as in the frequent application of the generally binding declaration of collective agreements.

The structure of the construction collective agreement system is characterized by a division into public works on the one hand (contractors that carry out infrastructure and other public works, for instance railway tracks and highway construction, tunnels

<sup>12</sup> The basic country report was written by Marcus Kahmann, political scientist and sociologist, Paris, France. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

and drains) and private construction on the other. For both sectors independent wage negotiations are conducted annually with three employers' associations, which are independent of each other (FNTP, FFB and Capeb). This does not exclude that agreements of the contractual partners show fundamental similarities since the industry federations on the trade union side have consciously not accepted any analogous organisational split.

In private construction and public works, there are three national collective agreements (blue-collar workers; administrative/technical employees; managerial and staff workers). For blue-collar workers and administrative/technical employees wages are negotiated regionally (and then declared generally binding). For the managerial and staff workers wages are negotiated at national level. For workers in private construction there are two – generally binding – national collective agreements, one for employees in enterprises with less, and another for enterprises with more than 10 employees.

Finally, social security funds are significant for the regulation of labour relations in construction. Both under- and non-declaration of labour are of equal concern. The first funds in the industry were introduced by law. Then, since the 1950s, the social partners have taken over the initiative. The following sector-specific social funds are jointly administered: the training fund financed by vocational training contributions, CCCA, the industrial accident prevention fund OPPBTP, the supplementary pension fund BTP-Retraite, the providential fund BTP-Prévoyance (guaranteeing continued pay and additional compulsory health insurance) and further training funds (GFC-BTP/AREF, FAF SAB, OPCA-TP). Only the bad weather compensation fund (Union des caisses de France, Congés-Intempéries – BTP) is not jointly administered.

### Taxation, social and labour law

The majority of taxes are levied by central State authorities. There is a distinction made between taxes on income (income tax, corporate income tax), value-added tax, transaction taxes and local taxes. The latter are levied by the local and regional authorities. Corporate income tax is 36.66% and income tax rates are between 12% and 56%, although tax deductions can reduce individual income tax rates. VAT is currently 19.6%. VAT taxes have to be declared by companies on a monthly basis. Business tax is levied by local authorities and, depending on turnover, rises up to 4%.

The social security system is divided into several branches. Wage-earning construction workers enter into the general scheme that assures the protection of workers who are employed in industry, commerce and other types of employees. The general scheme distinguishes between four segments:

- sick leave, maternity, invalidity and death;
- work-related accidents and diseases;
- old-age and widowhood pensions;
- family benefits.

These segments are administered by different institutions. A central agency named ACOSS is in charge of the joint management and supervision of these funds. The

funds are levied by the local benefits offices for the general social security scheme URSSAF. The contributions to social security are paid by employers and employees in equal shares. The sum depends on the wage level. Wage-related contributions make up about 67 % of the total expenses in social security. To cover the chronic deficit of the social security system, additional tax-based contributions were introduced in the 1990s (notably CRDS and CSG). Together they account for about 20 % of social security-related expenses.

Two other distinct institutions have a role to play in the French social security system: the unemployment benefit fund ASSEDIC that is administered jointly by the social partners (contributions are equally collected by the URSSAF) and a mandatory additional pension scheme for salaried workers, including those employed in agriculture.

### Liability Regulations

The notion of liability in the context of subcontracting has been laid down in the relevant law of 31st December 1975. It defines the rights and duties of the three principal actors of the economic chain in construction.

Being at the origin of the economic process, the client (*maître d'ouvrage*) has to consent to the subcontractors employed by the main contractor. The client is urged to remind the main contractor of the need to prevent the employment of a subcontractor carrying out illegal work. To prevent undeclared labour, the client may ask the contractor to show the contracts signed with the subcontractor(s). If undeclared labour is used then the client will be held responsible. Under certain conditions, the client can equally be made responsible for the payment of social insurance and taxes that should have been contributed by a subcontractor that employed undeclared labour or foreigners without a work permit.

The main contractor can equally be made responsible for the direct or indirect use of undeclared labour, the use of workers without a work permit, or illegal temporary employment.

### Licences and other regulations to prevent undeclared labour

French law provides for a whole series of licensing, business and labour law mechanisms, serving the prevention of undeclared labour. These were mainly introduced or refined during the course of the 1990s in order to combat undeclared labour. Checking compliance with these regulations (see below) is of great importance when undeclared labour is ascertained by the labour inspectorates:

- registration in the Trade and Company Register: this is prescribed for all physical persons and legal entities that are engaged in trading;
- registration in the Professional Register by legal entities or persons who do not employ a staff of more than 10 and who are active in the area of manufacture, processing or the provision of services;
- all persons whose occupation does not fall within the scope of the obligation to register in the Professional, Trade or Company Register (for instance independent

professionals, salesmen, farmers and foresters) must register without delay (there are various deadlines according to the type of business) with the benefits office for the general social security scheme URSSAF and the tax authorities;

- for the employment of workers in the private sector (with the exception of home helps or family helpers) the employer has to submit a preliminary declaration of hire (DPAE) to the URSSAF or the agricultural social security office before the employee's work starts. The DPAE has to contain data for identification of the employer, the identity and nationality of the employee, the date and time of hire and, for the agricultural social security office, the type and duration of the contract. The employee receives a copy of the DPAE from his/her employer unless it is part of the written contract;
- with the exception of individuals, every employer must keep a unified register of staff. This has to record the names of all staff (including those of home and agency

*Overview: Infringements and Authorised Supervisory Bodies*

Concealed labour	Criminal police Labour Inspectorate Tax Office Inspectorate Customs Social insurance
Bogus self-employment	Criminal police Labour Inspectorate Tax Office Inspectorate Customs Social insurance
Illegal employment relationships	Police and Gendarmerie Labour Inspectorate
Fraud in connection with drawing wage-compensating benefits	Police and Gendarmerie Labour Inspectorate Local Labour Office Unemployment Benefit ASSEDIC
Unauthorised supply of temporary workers	Criminal police Labour Inspectorate
Unlawful labour trafficking	Criminal police Labour Inspectorate Tax Office Inspectorate Customs
Violation of the law in connection with the employment of foreign workers	Criminal police Labour Inspectorate Customs
Fraud in connection with the use of foreign contractors	Criminal police Labour Inspectorate Tax Office Inspectorate Customs Social insurance

Source: DILTI 2005b, own compilation Marcus Kahmann.

workers) classified according to place of employment and the time of hire. In addition, nationality, date of birth, sex, occupation and professional qualifications, and the beginning and end of the employment relationship have to be declared. For foreign workers from non-EU countries, the type and number of the work permit and photocopies of these certificates have to be declared and attached to the register. Specific registers have to be held at all subsidiaries.

Transfers of wages by the employer must be accompanied by the issue of a wage slip, which has to be issued at a set time once a month.

## Nature and features of undeclared labour

### Definition

Law 2005-882 of 2nd August 2005 associates a whole series of different practices with the concept of illegal labour. The connection between these different practices is that they contravene elementary provisions of the employment laws and either occur within a company (either a contractor or someone who is self-employed) or an employment relationship. By definition infringements may be committed by both French and foreign service providers. All persons participating in the performance of illegal labour, including clients, may be prosecuted. The legal system particularly targets the originators of the illegality. In the presentation of facts regarding undeclared labour by French law, particular importance is attached to ‘concealed labour’ since the majority of practices of undeclared labour can be subsumed under this category.

According to the interviewees that were part of this research, recruitment of illegal workers takes place essentially by word of mouth. Generally, the participating players (employer and employee, and possibly clients) know each other. The role of social networks in the organisation of undeclared labour has been confirmed by Laé (1989). In his ethnological study on individual informal (shadow market) labour (albeit not specifically in construction) he points to the frequent alternations between legal and illegal labour. These alternations were simplified by the fact that the people involved had formerly acquired competencies and contacts in regular jobs. To be offered the desired jobs, a person has to be permanently available to develop and extend their relations with others. But the constant pressure to (re-)activate social networks means that the idea of ‘working for yourself’ turns out to be an illusion. Mozère (1999: 65) emphasises that in the relationships underpinning the networks, being able to “keep a secret” plays a strategic role. The necessary trust can only be obtained by dense social relationships based on mutual indebtedness.

### Different forms

#### *Concealed employment*

This is where independent profit-orientated activities intentionally breach trade rules or tax or social legislation. This is established by criteria such as advertising, type and regularity of the activity or lack of/contrived invoices. Intent is assumed if an activity

or receipts are hidden consciously and systematically in order to avoid payment of taxes and social insurance contributions. Even if an intentional action in the sense of a concealed employment cannot be ascertained, the relevant sanctions are applicable in accordance with tax and social legislation. The ways in which these infringements of the law manifest themselves are the failure to register in the Trade and Company or Professional Register, or failure to declare at the URSSAF or at a tax office. Differences may be ascertained by the extent of failure to declare (for example, totally undeclared independent work, tax fraud by a regularly declared self-employed individual through work without an invoice).

#### *Concealment of an employment relationship*

Employers commit an offence if they, having engaged an employee, intentionally either did not submit the DPAE or have not sent the compulsory monthly wage slip to the employee. All private individuals and company management engaging staff, regardless of the size of the enterprise or sector, must hold both types of document. An offence is also committed if the employer did not reveal all the hours worked during the period to which the pay slip refers (with the exception of collective agreement provisions for annual working time accounts).

#### *Bogus self-employment*

Generally, the bogus self-employed person is registered in the relevant professional registers and with social security and the Tax Office. In reality, however, he/she is an integral part of the company; the company's management organises all his/her activities, and directs and controls the undertaking of their work as it does with its dependent employees. Therefore he/she works under the same conditions as an employee without being able to claim the relevant rights. Legally, employment of bogus self-employed individuals falls into the category of concealed employment and companies are prosecuted with the same penalties.

#### *Illegal accumulation of employment relations*

This is applicable firstly to all employees in the public service (officials and public employees) and, secondly, for employees in private industry if the total time they work is longer than 48 hours per week. Both the employee and his/her employer may be prosecuted, which could lead to a fine of €1,500 being imposed.

#### *Fraud in connection with receipt of wage-compensating benefits*

If a recipient of wage-compensating benefits (unemployment benefit, early retirement) takes on a new occupation (as an employee or as an independent worker) without declaring it, then they may face a two year prison sentence and a fine of €3,750.

#### *Illegal supply of workers*

This category includes the supply for profit of workers by one company to another, something that is forbidden by French labour law. An exception to this is the supply of workers within the legal frame of temporary employment and modelling and artists' agencies. Illegally provided employees have no special qualifications or duties and are

placed under the supervision of the client. Lenders and users are considered as co-perpetrators of the criminal offence and both are subject to legal prosecution. Individuals may receive prison sentences and a fine of €30,000; legal entities risk, among other things, a fine of up to €150,000.

### *Trafficking of workers*

While the supply of workers is illegal outside the legal framework of temporary employment agencies, the supply of services for profit, notably in the form of sub-contracting, is not. However, if in such a case disadvantages result for the employee from the profit-making supply of labour through a contractor breaching legal or collective agreement provisions, then French law regards this as trafficking of workers.

### *Law breaking in connection with the employment of foreigners*

The employment of foreigners from non-EU countries rests on the principle that the entry of the employee for the purpose of accepting employment in France depends on the approval of the national employment and immigration administration. Approval of an employer's application depends on an evaluation of the specific labour market situation. In principle, precedence is given to resident applicants in the granting of employment.

The law also prohibits the employment of residents in France without a work permit. Employers are encouraged to gather information systematically regarding the nationality of their employees, as well as to check regularly their situation in respect of the right to remain and to update this in the register of staff. It is prohibited for the employer to:

- pay for the recruitment of a foreign employee;
- falsify documents with the aim of obtaining a work permit;
- give financial assistance for entry, residence and travel;
- give access to a foreign employee or grant a work permit through a temporary employment agency.

The employer (including private individuals who commission work) or their representative, as well as beneficiaries of the fraud in so far as they had knowledge of it (touts, middlemen, and so on), can be prosecuted. Employees without a work permit will have their temporary residence permits taken away from them.

### *Fraud in connection with the employment of foreign companies*

Three cases of transnational service provision are differentiated:

- if a service provider provides a service that has a certain time limit without posting employees (for example, a self-employed worker) certain social and tax provisions are applicable, for instance the payment of VAT or the proof of the payment of social insurance by the service provider or his/her representative. If an enterprise uses posted workers, among other things the national labour legislation and the generally binding collective agreements are applicable;
- all the statutory tax, social and commercial regulations are applicable to foreign companies permanently active in France;



- the currently valid statutory social and labour minimum provisions are applicable to employees of a foreign service provider that is active on its own account for a limited period of time. Companies from third countries need work permits for their employees. Breaches of the law take the form of a concealment of the company head office (either no head office abroad at all or in the form of a post office box address, in order to circumvent legal obligations). These companies are treated in law like undeclared French companies. The sanctions therefore correspond to those in the event of concealed employment by failing to register with the Trade or Professional Register, failure to pay tax and social insurance as well as failing to supply DPAE or pay slips.

An increase in transnational service activity is reflected in information supplied by the Ministry of Labour and Employment. According to the Ministry, since 2003 the number of notices of posting received by the Labour Inspectorate has increased by 80 % to 6,163 (covering 23,101 employees). It has to be underlined that these figures only refer to registered postings. There is ample evidence that in reality the number of postings is considerably higher as much of the transnational provision of service activity remains completely undeclared. The most common transgressions include the illegal supply of temporary workers, violations against the right of settlement, the false declaration of employees (false trainees, bogus self-employed, false honorary offices) as well as failure to register for social insurance in the countries of origin. It was not possible to explain conclusively whether there are specific reasons for an increase in reverting to posting companies, apart from the changed circumstances of enlargement and the expectation of more favourably priced provision of services.

According to the data of the DILTI interlocutor, 17 % of the economic activity in construction is allotted to subcontractors. Frequently in this organisation of the production process, there is no financial room for manoeuvre for the contractors at the end of the subcontractor chains for employing labour in a correct manner. This was absolutely clear in the opinion of the Labour Inspector when questioned about the higher levels of the subcontractor chains. The fiercer the competition and the dependency from the main contractor, the greater is the risk for companies and employees to revert to undeclared labour. This observation concurs with the analysis pursued in a number of studies which have found that subcontracting allows large contractors a flexible and less cost-intensive use of labour through linking formal and informal economic activities. However, the FNTF does stress that the knowledge of main contractors about the use of undeclared labour by the authorised subcontractors was often inexact – the use of undeclared labour would in reality often be higher. FNTF recommends that its members should be on their guard, particularly when confronted with exceptionally low quotations or unrealistic deadlines by subcontractors.

## Extent

The analysis of the characteristics of undeclared labour is based essentially on DILTI data (records received from the regional authorities for labour, employment and further vocational training). The data thus touch exclusively on cases ascertained

Table 1: Types of Violation of the Law in the Construction Industry, 2004

Violation of the law	Demolition and excavation		Civil engineering		Piping		Finishing trades		Construction overall	
Use of concealed employment, deliberate omission of preliminary declaration of engagement (DPAE)	34	44.1%	768	40.9%	103	37.9%	121	36.3%	1026	40.1%
Contractor's failure to register	6	7.8%	183	9.7%	30	11.0%	56	16.8%	275	10.7%
Employment of a foreigner without a work permit	3	3.9%	207	11.0%	27	9.9%	24	7.2%	261	10.2%
Failure to register with social insurance	2	2.6%	149	7.9%	21	7.7%	20	6.0%	192	7.5%
Various violations with regard to illegal labour	7	9.1%	141	7.5%	22	8.1%	23	6.9%	199	7.6%
Use of concealed labour, deliberate failure to issue a pay slip	6	7.8%	126	6.7%	17	6.3%	25	7.5%	174	6.8%
Use of undeclared labour	5	6.5%	90	4.8%	14	5.1%	27	8.1%	136	5.3%
Illegal supply of labour	7	9.1%	55	2.9%	6	2.2%	1	0.3%	69	2.7%
Failure to pay tax	2	2.6%	43	2.3%	10	3.7%	11	3.3%	66	2.6%
Illegal labour trafficking	1	1.3%	29	1.5%	4	1.5%	2	0.6%	36	1.4%
Violation of the regulations for preliminary declaration of hire (DPAE)	2	2.6%	19	1.0%	7	2.6%	7	2.1%	35	1.4%
Assistance to a foreigner for illegal border crossing and stay	1	1.3%	19	1.0%	4	1.5%	7	2.1%	31	1.2%
Concealment of part of the hours worked	0	0%	15	0.8%	0	0%	3	0.9%	18	0.7%
Failure to display a notice of works in progress (permis de construire)	0	0%	6	0.3%	2	0.7%	1	0.3%	9	0.8%
Illegal acceptance of social benefits by the unemployed	0	0%	8	0.4%	1	0.4%	0	0%	9	0.4%
Assistance to a foreigner for illegal border crossing and stay	0	0%	6	0.3%	0	0%	3	0.9%	9	0.4%
Missing despatch advice	0	0%	6	0.3%	3	1.1%	0	0%	9	0.3%
Social benefit fraud	1	1.3%	4	0.2%	1	0.4%	2	0.6%	8	0.3%
Illegal accumulation of employment relationships	0	0%	2	0.1%	0	0%	0	0%	2	0.1%
Assistance in income support fraud	0	0%	2	0.1%	0	0%	0	0%	2	0.1%
<b>Total</b>	<b>77</b>	<b>100%</b>	<b>1878</b>	<b>100%</b>	<b>272</b>	<b>100%</b>	<b>333</b>	<b>100%</b>	<b>2560</b>	<b>100%</b>

Source: DILTI 2005b, own calculation Marcus Kahmann.

during the supervisory activities of the Labour Inspectors. Therefore, they do not provide an accurate portrayal of the reality but rather indicate tendencies and trends. They also allow for comparisons of the occurrence of individual infringements.

Table 1 shows violations of the law in construction in 2004 according to trade branches. Comparing the subsector data of construction with the inter-professional data demonstrates that the proportion of the respective forms of illegal labour correspond approximately to the inter-professional percentage rates. This may be an indication that the nature of the phenomenon in construction is not substantially different from other sectors. The majority of the violations concern the use of concealed labour, at about 40%, in connection with a violation against the DPAE regulations.

Notable deviations from the inter-professional average occur first and foremost in the event of violation of the law by companies failing to register. Here, the percentage rate in construction across all subsectors (10.7%) is clearly below the inter-professional average of 15.2%. Therefore, even if the figures do not allow further differentiation, informal companies and self-employed seem to be less frequent than in the inter-professional average. Likewise, below-average values occurred for construction in concealment of actual hours worked (0.7% to 2.1%). On the other hand, values that are clearly above average are to be noted for illegal employment of foreigners (10.2% to 7.2%). It is also noteworthy that, at low level, crimes in connection with supply of labour or labour trafficking in construction are clearly more frequent than the inter-professional average (2.7% compared with 1.4% and 1.58% compared with 0.76% respectively).

The trade-specific distribution is also of interest. In the area of demolition and excavation the proportion of use of concealed labour in connection with a missing DPAE (44.1%) is clearly above the industry average. The above average number of offences in the context of pay slips (7.8%) also indicates a high proportion of undeclared or partially declared labour. This corresponds to a below-average proportion of offences in connection with independent enterprise activity (failure to register in the Trade Register). On the other hand, the proportion of concealed employment of workers in connection with an incorrect DPAE in trade-specific violations of the law in the plumbing and finishing trades (37.9% and 36.3% respectively) is slightly below the industry average. The central indicator for the presence of informal companies – failure to register in the Trade Register – occurs in both subsectors with above average frequency (11.0% and 16.8%). With regard to the employment of foreigners without a work permit, it is noteworthy that these are found with greater than average frequency in civil engineering. There is also a lower proportion of fraud in wage-compensating benefits in the construction industry.

*Table 2: Percentage Distribution of Violations of the Law with regard to Enterprise Size in the Construction Industry, 2004*

Employees	no employees	1 to 10	11 to 50	More than 50	No data
	10%	70.4%	2.5%	0.5%	16.6%

Source: DILTI 2005b.

According to Table 2 a majority of violations of the law occurred in the smallest companies. This is confirmed if the number of employees per category is taken into account: 1 to 10 employees with 35 %, 11 to 50 with 33 %, more than 50 with 32 % of total employment in construction.

## Functioning of the undeclared labour market

### Segments

The assumption of a concentration of undeclared labour in private building services coincides with the view of the Paris Labour Inspectorate. According to the representative interviewed for this research, it is found first and foremost in secondary contract work; the proportion of small companies is particularly high and thought to contribute to the phenomenon. Also particularly affected is bricklayers' work and plumbing, since here the qualifications required are not as high as, for instance, electricians' work. Sionneau (2000: 5) reinforces this by stating that three quarters of the moonlighting occurred in the area of house building. Secondary contract work in the private house building sector and renovation work were particularly affected. A point in question is the role of the private demand for cheap labour in the current private construction and renovation boom in construction. The difficulty for labour inspectors to monitor these activities, due to legal constraints, and the size of certain sites unquestionably facilitates the use of undeclared labour because those who are participating do not have to take too many risks.

It is unanimously reported that the majority of undeclared labour is found in small and very small companies (less than 10 employees). This is true in particular for the use of concealed labour. According to the experience of the Labour Inspector, the larger companies adhered as a rule to current regulations. When violations of the law are noted in large companies, these are against current provisions regarding overtime. However, on construction sites employees of such companies are hardly likely to be found. This observation points to the profound changes in the organisation of the production process over the last 20 years, notably the widespread use of outsourcing by large contractors. These have concentrated increasingly on the organisation of the production process (as well as canvassing for clients and other services) and the externalisation of their own activities. The growth of the number of small enterprises has to be understood in that context. The development corresponded with new, more flexible (and precarious) forms of the use of labour – such as temporary agency work, self-employment, subcontracting or the posting of workers – that reinforced the segmentation of the labour market. Marie (1997) makes the point that more sophisticated forms of undeclared labour have developed at the margins of these forms. Indeed, FNTP and FFB currently see in two of them – the transnational provision of services and the subcontracting chains – the main sources of undeclared labour.

All interviewees reported that forms of undeclared labour regularly occur in transnational operating posting companies. The number of companies or bogus self-employed people active in this has significantly increased since the eastern expansion of the EU, especially since France, unlike Austria and Germany, has not imposed

industry-specific special regulations for the freedom to provide services. The recent increase in posting activity is perceptible also in comparison to the results presented in a previous study in the sector.

## Reasons

The relationship between the use of undeclared labour and the business cycle is far from clear. A simple inverse relationship between economic growth and the spread of undeclared labour cannot be sustained, as is demonstrated by the current situation in French construction. Similarly, economic downturns do not necessarily seem to result in massive increases in the use of undeclared labour. Evidence rather points to a relatively stable amount over time, the economic functions and forms of which may vary according to changing business requirements. Certainly, the phenomenon is deeply embedded in the ways of working of some clients, companies and workers.

During the research, three functions of undeclared labour for companies emerged. Not surprisingly, the emphasis changed according to the position of the interviewees in the production process, and the wider sphere of social reproduction.

Firstly, undeclared labour compensates time deficits in completing orders. Secondly, it circumvents administrative hurdles. High social insurance contributions and rigid working hour regulations tempt some employers to revert to illegal labour. In particular, FFB underlined the significance of this point, suggesting that the existing overtime regulation was seen as too rigid. The same level of infringement in the context of working-time regulations could not be assumed with other forms of undeclared labour. Thirdly, it helps to reduce the production price and to achieve extra profits. Trade unionists and labour inspectors put forward this point as the essential motivation of employers to use undeclared labour.

## Effects

Two primarily negative effects were perceived in the interviews as consequences of undeclared labour:

- unfair entrepreneurial competition that allows extra profits or enables less productive companies to stay in the market: the labour inspector interviewed felt that in some subsectors of secondary contract work the tender prices were so low on account of the spread of undeclared labour that contractors employing in accordance with the tax and social security regulations would inevitably be outpriced. Increasingly, small enterprises in these subsectors were about to reduce their levels of employment in order to concentrate on obtaining contracts and to use illegal subcontractors or labour. For the FNTP the problem posed by unfair competition was primarily due to the freedom to provide services. Social insurance contributions are due in the country of origin, at least for Eastern European companies, and this is an important competitive advantage;
- industry image: in public, undeclared labour is often associated with the construction industry. For employers, this is seen as a problem for workforce recruitment. In the view of the DILTI there might potentially be a self-reinforcing effect, consisting of the following elements: workforce shortages which means that

companies revert to illegal forms of employment, which leads to a negative industry image, which leads back to workforce shortages. It may be noted that the analysis of an industry-specific labour force shortage was not shared by all interviewees. For the labour inspector the workforce did exist, it only had to be declared. For the CGT it went without saying that, given a current unemployment rate of 9.5%, it was forbidden to speak of a workforce shortage. If there was a recruitment problem, this was due to the real remuneration and working conditions which were emphasised, for example, by the high percentage rate of young people who broke off their training.

It is also possible to add other negative consequences of undeclared labour such as revenue losses for public authorities and social insurance funds. Other regulations and standards (health and safety standards, and statutory and contractual employment regulations more generally), as well as trade and commercial law regulations are also put under pressure by undeclared labour.

## Measures

### Integrative measures

The policy aimed at the reduction of taxes for companies for combating illegal labour basically includes two measures relevant for the construction industry.

For builders and contractors authorised to carry out renovation and maintenance work, a tax-based exemption clause has been applicable since September 1999 in the form of a VAT rate reduced to 5.5%. This reduction took place in harmony with European Directive 1999/85/EC. Since the Council of Europe approved the extension of the relevant national exemption clauses in labour-intensive sectors of industry in February 2006 until 2010, the relevant regulation has found further application.

A second tax-based tool for combating undeclared labour is the Chèques Services for personal care services in the employer's household. Cheques for services were introduced for the first time in 1995. In the first year after their introduction 140,000 employers made use of the cheques, without the number of quarterly social insurance declarations to URSSAF decreasing (Seuret 2004). At present there are about 900,000 cheques users. The area of application of this measure encompasses among other things unskilled manual, garden or household jobs. Since the latest reform in July 2005 these have been called Chèques Emploi Service Universel (CESU) and allow the employer to obtain from a central authority most of the usual formalities when hiring (drafting of a contract of employment, issuing a pay slip, calculating and paying social insurance contributions). He/she can claim 50% of the wages paid against their income tax and benefit from reduced social insurance contribution rates. In exchange the remuneration must correspond at least to the national minimum wage (SMIC).

In 2003 the RMI (Revenu Minimum d'Insertion), a minimum income support existing since 1988, was complemented by the RMA (Revenu Minimum d'Activité, which is a minimum income for professional activity). The RMA represents a new type of contract of employment, which allows an employer to engage a person on

long-term supplementary welfare benefit for the duration of at least six months for a weekly working time of a maximum of 30 hours, whereby the RMA to be paid by the employer supplements the RMI which will also be paid out. The amount of the minimum wage is calculated on the basis of the SMIC hourly rate. Although the main emphasis of the measure was reintegration into the labour market, considerations for facilitating those in receipt of the benefit in obtaining a legal additional source of income to the RMI may also have played a part.

A further socio-legislative measure for combating undeclared labour is offered by the possibility of releasing the self-employed from National Insurance contributions. Within the frame of the law of 1st August 2003 for the promotion of economic initiative, exemption in the first 12 months of business may be granted.

Non-EU foreigners staying in France without a work and residence permit are forced to perform undeclared labour to survive (Terry 1999). One of the measures to address this problem is to regularise this mostly illegal population. The latest large-scale regularisation of immigrants without residence permits took place in 1997.

Finally, the Legislative has been attempting for some years to dismantle administrative hurdles to facilitating the founding of companies.

## Enforcement measures

For the current two year plan (2006-2007) the industry focus will be maintained. It includes six inter-professional aims:

- intensification of supervisory activities;
- implementation of the newly created sanction possibilities, which were created by decree with effect from 1st January 2006. These aim to contain violations of the law in the area of subcontractor activity and transnational service provision;
- combating fraud by transnational service providers and employment of foreigners without a work permit;
- development of information and prevention through, among others, the inclusion of management and labour in public campaigns;
- making the supervisory bodies aware of the widespread practices of circumventing labour status (through bogus trainees);
- better evaluation of campaigns and their results through, among others, the computerisation of tickets.

Finally, the catalogue of punitive measures was extended further so that companies acting against the law could be excluded from receiving public subsidies and assistance for further training, and barred from engaging employees.

## Good practices

At the initiative of the central actors among construction employers an information campaign was started in October 2005 as a preventive measure, which aims at making existing legal regulations in connection with domestic and foreign subcontracting

more widely known. This is in accordance with the perception expressed during the research interviews that practices regarding undeclared labour were concentrated in this area. It is directed at subcontractors, clients and contractors. The employer associations reacted the most to the changed legal situation and the spread of the practice of posting in the construction industry. The DILTI and the trade unions were included in the initiative. This cooperation produced in essence two documents. The flyer on subcontracting and undeclared labour in the construction industry ('Sous-traitance et travail illégal dans le BTP. Que dit le droit? La charte du BTP') is distributed by the regional labour and employment authorities, the chambers of commerce and the URSSAF. The regional branches of the employer associations also pass on these brochures to their members. CAPEB, for example, recommends that its members attach the document to every agreed subcontractor contract. A second document specifically produced for clients, builders and subcontractors, explains existing legal regulations in the form of questions and answers. This can be obtained both through employer associations and online from the ministries. It cannot yet be stated to what extent this has contributed to the reduction of irregular practices.

A further entrepreneurial initiative concerns the introduction of a pass with the name of the employee, their social insurance number and the name of the company, which construction workers always have to carry with them. This measure is supported above all by the FFB construction workers' association and has been running for some years. Since participation is on a voluntary basis and at present not even supported by all employer associations, it has to be assumed that its spread will be limited.

On the trade union side, the CGT has written a manual on how to limit undeclared labour in subcontracting chains. This document invites the workers' representatives in the committees for health and safety and working conditions to exercise their right to have management give them the names of the subcontractors and type of works to be carried out. Works councils are also urged to make use of their rights to information (for example, regarding the number of employees appointed by subcontractors) and, in the event of sufficiently suspicious circumstances, to call in the Labour Inspectorate. The right of industrial action allows trade unions to bring relevant cases before the labour courts in so far as an affected employee does not make an appeal. What is more, CGT calls for a right of access for trade unions or for individuals authorised by the trade unions to construction sites, in order to be able to carry out independent checks.



# Germany<sup>13</sup>

## Regulation and institutions

### Legal provisions

#### *Law for the Prevention of Illegal Employment in Construction*

A general contractor liability for subcontractors was introduced with this law. The general contractor has to periodically withhold 15 % of subcontractor charges and pay them to the tax office. Thus, possible tax evasions can be met head-on.

#### *Law on Simplifying the Fight against Illegal Employment and Undeclared Labour*

This law introduced a series of improvements to the control of undeclared labour. General contractors were obligated to bear responsibility for the social security contributions of subcontractors commissioned by them. Generally, the authorities' options for cooperation in prosecution were improved and the scope of penalties and administrative fines increased. Advertising possibilities for illegal labour were limited.

#### *Law on the Intensification of the Fight against Illegal Employment and Related Tax Evasion*

With this law, the definition of undeclared labour was stated more precisely. It contains the exemption provision according to the Handicrafts Regulation for industry implementation, insignificant employment, ancillary companies and irrelevant subsidiary businesses. The law also included the obligation to invoice and the obligation to preserve invoices and additional improvements of control- and inspection rights in the prosecution of this type of tax evasion.

<sup>13</sup> The basic country report was written by Wolfgang Richter, CLR-Dortmund, Germany. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

*Law on Loyalty to Collective Agreements (rejected in the Bundesrat in 2002)*

With such a law, the public contract placing authorities would have been required to award construction contracts only to companies that base their cost estimating and building on the adherence to pay collective rates and also demand these rates from their subcontractors. Controls by the contract placing authority should be possible. With this federal law, the initiated practice in laws in several federal states (Bavaria, Berlin, Bremen, Lower Saxony, North Rhine-Westphalia, and Saarland) had to become generally applicable throughout the whole of Germany. Currently, several of these state laws are being questioned politically and juridically.

### Minimum wages in construction

The minimum pay for the generally binding applicable collective wage agreements is changing with the results of wage negotiations. In 2005/06, the minimum wages in the construction industry amounted to:

- wage group 1: € 10.20 (old federal states) or € 8.80 (new federal states);
- wage group 2: € 12.30 (old federal states) or € 9.80 (new federal states).

Currently, 42 % of employed persons in companies in the new federal states and 19 % of employed persons in companies in the old federal states receive this minimum wage; the average wage of other registered employed persons is above the minimum.

### The Federal Customs Administration – Department for Financial Control of Illegal Labour (FKS)

The central task of preventing, registering, and punishing undeclared labour is concentrated in the Federal Customs Administration and specifically within the Department for Financial Control of Illegal Labour. Its main emphasis is on the construction industry, the hotel and restaurant industry, the meat processing industry, the delivery, transport and logistics industries, and in the taxi industry. The number of staff has increased in the last few years by bringing together customs personnel with government employment office staff previously in employment market inspection (currently about 7,000 employees).

## Nature and features of undeclared labour

### Definition

The Law on the Intensification of the Fight against Illegal Employment and Related Tax Evasion defines undeclared labour as:

“Whoever performs undeclared labour provides service or labour or has commissioned it and in doing so,

1. does not fulfil his ensuing obligation based on the social security law to register, pay contributions – or comply with the duty to keep records for service – or work

- as employer, contractor or self-employed person liable to pay social security contributions;
- 2. does not fulfil his ensuing tax obligations as a taxpayer based on the service or labour provided;
- 3. does not fulfil as a recipient of social benefits his ensuing disclosure requirements, based on the service or labour provided, to the social security authorities;
- 4. does not meet his ensuing duty to register an existing trade from the commencement of the independent company or has not acquired the necessary peddler's license as provider of service or labour;
- 5. independently conducts a licensable craft as an existing trade without being registered in the roll of craftsmen as provider of service or labour."

In essence, undeclared labour is therefore:

- 1. an infringement of social security law;
- 2. an infringement of tax law;
- 3. an infringement of the duty to notify the government employment and welfare agency;
- 4. an infringement of the Industrial Code (GewO);
- 5. an infringement of the Handicrafts Regulation (HwO).

Jobs for family members or partners as a favour in the course of helping neighbours and for self-help are not considered undeclared labour if they are not intended to make a profit.

In the public debate on working conditions in Germany, the terms 'shadow economy' and 'informal labour market' are also used, which however each contain by themselves more than the accepted facts of the laws on illegal employment – for example, one's own work in the household or family, community work nearby the household, honorary activities.

An additional concept in the discussion about employment conditions in Germany is the 'second employment market' – it does not comprise undeclared labour, but rather designates declared labour that, based on publicly financed programmes, is not or only partially subject to the social security and tax laws and partially or completely exempt from the obligations in these laws. It is based on employment market and socio-political programmes, laws and ordinances, and has the declared task of reintegrating the untrained and unemployed into the 'first employment market'.

## Different forms

### *Individual PLC ('Ich-AG'), one-person company, bogus self-employment*

The work of a classic gang of construction workers falling under collective agreements can be carried out by bogus self-employed persons in a working team. Since January 1st 2004, an enormous number of such 'companies' have come into existence, especially in the areas taken out of the Handicrafts Regulation.

In the field of tiling there were about 12,500 independent companies on January 1st 2004; by June 15th 2005, that number had increased to 32,500. Of the new registrations, about 75 % are so-called one-person companies, of which about 25 % are of foreign nationality. In the field of concrete floor laying there were about 1,650 independent companies on January 1st 2004; on June 15th 2005, about 3,100.

As a rule, the newly registered owners are without certified vocational qualifications. Among the tilers, about 80 % are unqualified and among the floor layers, about 90 % are unqualified.

These companies do not fall under the Posting of Workers Act and thus are not obliged to comply with the generally binding minimum wage. Bogus self-employment is in many cases linked to – and dependent on – material suppliers (iron, concrete, tiles and so on) or the production of tools (such as vehicles, elevators and cranes).

At the moment, individual PLCs receive government support for three years upon application in their setting-up phase, in amounts that decline annually.

#### *Non-profit job creation companies*

These concern external rescue companies in the case of liquidated companies. From here, unemployed persons (as a rule trained and experienced) are placed in regular companies for a fixed time, in order to perform training or an internship. This costs the company only a small fee compared to minimum wages. The process is based on government support.

#### *Employment creating infrastructure measures*

In this programme, companies receive subsidies when they hire unemployed persons for the completion of government contracts. Subsequently, regular jobs in the company can be eliminated. The process is based on government support.

#### *One-euro jobs*

These are “job opportunities with additional expenditure compensation” that primarily concern the long-term unemployed who are to be helped back into the job market. Increasingly, these opportunities are being taken by local authorities and social-industrial institutions of private agencies for regular labour. In construction, they are ousting normal jobs, primarily in finishing, deconstruction and conversion, and in demolition, horticulture and landscaping. The process is based on government support.

#### *Combination wage*

Currently, experts are (again) reviewing whether jobs with wages that are (too) low should be publicly supported using government wage subsidies in particularly precarious areas of unemployment – first and foremost among older unemployed persons and the long-term unemployed. It is still unclear if this should also take place in the construction sector.

#### *Informal construction labour market*

Self-organised work without registration of business or entry in the roll of craftsmen, often in interconnecting networks of various trades and occupations, sometimes in

longer value-chains from the planning to the finish, especially in conversion, renovation and modernisation. This market does not fall under the regulations for declaring labour and is not considered undeclared labour, as long as no striving for profit on a commercial basis exists or rather can be registered. As a rule verification is difficult, especially where criminal engagement is involved.

### Extent

In 2004, the Organisation for Economic Cooperation and Development (OECD) published an international comparative study that compared the actual payments to social insurers with the theoretically obligatory contributions. According to this study, 10% of the potential obligatory contributions in Germany were not made in the year 2000.

The statistics still do not provide any branch-specific data. The following were recorded throughout all branches:

- inspections of persons at work sites in 2002: 77,000, 2003: 79,000, 2004: 264,000 and 2005: 356,000;
- inspections of employers in 2002: 26,000, 2003: 32,000, 2004: 105,000 and 2005: 78,000;
- conclusion of preliminary investigations because of criminal offences in 2002: 8,700, 2003: 9,800, 2004: 57,000 and 2005: 81,000;
- conclusion of preliminary investigations because of administrative infringements in 2002: 1,700, 2003: 1,200, 2004: 50,000 and 2005: 54,000;
- in 2005, the sum of administrative fines amounted to € 67 million, the value of secured assets for skimming off of assets € 13 million; the sum of fines (including compensation for lost value) from judgements and orders of summary punishment € 21 million. In comparison, the damage amounts in the scope of criminal and administrative investigations amounted to € 583 million; the total of affected prison sentences, to 995 years.

In the construction industry, the following were recorded:

- inspections of construction company employers in 2004: 34,000 and in 2005: 24,000;
- administrative offence proceedings initiated against employers in 2004: 6,700 and in 2005: 10,500;
- criminal proceedings initiated against employers in 2004: 3,300, in 2005: 3,100.

## Functioning of the undeclared labour market

### Actors

#### *Letterbox companies in foreign countries*

An expanding service industry in Western Europe and increasingly in Eastern Europe is the establishment, registration and management of letterbox companies.

Construction companies founded in Great Britain, Portugal or in Eastern Europe post workers to Germany, on the basis that their taxes and social security contributions are supposedly paid in their own lands. This process cannot be checked promptly enough by the competent Department for Financial Control of Illegal Labour due to the official channels passed through from the construction site to the letterbox. Often it is a matter of organised crime, which hitherto has been ineffectively combated.

#### *Cover companies and 'cheque cashers'*

The so-called 'cover companies' are bogus companies. They issue fictitious invoices for non-performed subcontractor services, with which the main company claims increased business expenses and can reduce VAT payments. Generally, by the time the fraud is recognised by the tax office, the bogus company is dissolved. In the meantime, payments made by the main company to the bogus companies are collected by the so-called 'cheque-cashers' and returned in cash after deduction of commissions.

#### *Double entry book-keeping*

For the deceptive evasion of the generally applicable minimum wage, working times of 160 hours per month at minimum wage, for example, are recorded in the books. However, in reality 200 hours are worked and payment for the 40 additional hours is only recorded in a second book-keeping entry as working hours and without corresponding payments to the social fund, social security and taxes for these additional working hours.

#### *Direct debit authorisation for payroll accounts*

At the conclusion of the contract in their home countries, workers are forced into the collateral agreement to issue direct debit authorisations for their payroll accounts to the employing contractors. Portions of workers' wages are then deducted again. Despite formal adherence to the generally applicable minimum wage in the transfer to the payroll account, much lower or the lowest wages can be paid in this deceptive manner, without any kind of controls intervening.

#### *Misuse of social benefits*

Recipients of social benefits may only have a certain number of hours and a specific amount of additional earnings. If the specified amount is exceeded, the excess amount is charged against the social benefits. In case of abuse, only labour provided under the generally binding conditions with regard to working time and wage rates is as a rule registered, even if an employee works longer and below the minimum wage.

Recently, employees in collectively agreed short-term jobs who cannot achieve a minimum standard of living with this work (currently about 900,000 people), have also received extended social benefits up to the amount that they are legally entitled to. They work for low wages (even up until 48 hours legal working time) and still need unemployment benefits to earn a decent minimum wage. As the de facto mixed earnings are paid out of the tax based unemployment payments this leads in practice to a cut in payments for social security.

### *Work without a regular contract*

Such construction work can be organised for the widest variety of reasons and take on the most widely differing forms:

- additional work of employees working under collective wage agreements in exceptional business situations, with key personnel systematically thinned-out regularly (classic overtime), which is not declared or declared at a lower value;
- comparable work of others, as a rule insignificant or lesser paid employed persons in other contractual conditions, for the same reason and in the same form;
- comparable work of non-employed persons, day labourers among others.

### Segments

Generally, several focal points can be determined, which however cannot be verified with data. Here experts primarily report opinions:

- vocational focal points: iron bending, tiling, scaffolding, demolition work;
- qualification focal points: unskilled and skilled operatives, increasingly salaried activities as well (bogus self-employment, as a rule two-year long 'internships');
- technological focal points: interrelationships can especially come about with changing prefabrication levels with increasing assembly, services installation and finishing work;
- company sizes, subcontractors, market segments: interrelationships cannot be precisely discerned; however, general contractors frequently accept and approve that subcontractors cannot estimate and offer their prices without falling below the minimum wage;
- economic cycles: interrelationships cannot be precisely discerned, most likely in cycles in the posting states (from which fewer workers depart from if their construction sector is functioning or even booming); in one's own state, undeclared labour promotes crisis and recession;
- contractors: primarily public sector and private big companies, but also private, small builders;
- regions: increasing retreat to the legal minimum wage in the old federal states; increasing wages and a noticeable reduction in undeclared labour in the new federal states.

### Reasons

The arguments, primarily from employers' federations, chambers of crafts and industry, and politically from supply and market oriented tendencies, explain undeclared labour as due to wages that are 'too high', pressures of collective wage agreements that are 'too rigid', tax rates that are 'too high', bureaucracy and regulation density that are 'too restrictive', which, taken together, disproportionately burden properly declared labour and make undeclared labour seem profitable.

The argument primarily from the labour unions, social protection associations and politically from the demand and regulation oriented tendency explains

undeclared labour as due to unemployment that is 'too high', border-crossing employment that is 'not controlled enough', 'insufficient' general contractor liability regarding subcontracting activity, and the lack of a nationwide corruption register and a Law on Loyalty to Collectively Agreed Standards – which, taken together, leads to the exploitation of the available growing 'reserve armies' in one's own and other countries by undeclared labour.

The prevailing theory and practice of neo-liberal economics and policy concerns overall a strategy to lower the value of labour and thus reduce the share of variable capital as a factor of production. Concretely, this means a general reduction of legally determined standards collectively agreed to and made in the labour market and workplace with the goal of securing profitability of invested capital in production or service. A reduction of costs is thus achieved for investment and for labour in the public sector – nation, states and municipalities in Germany are so underfunded that they can only fulfil their tasks in guarantying infrastructure and in providing for lives under conditions that can no longer be maintained without further undeclared labour.

In important trades, and in the construction sector, registering in the roll of craftsmen is no longer required, so that companies may also be set up without master qualifications and services can be offered and carried out with less regulation.

## Dynamics

The societal, economic and political bases upon which undeclared labour develops and spreads are regularly masked and are not made an object of efforts. On the contrary, it can be presumed that the current high level of proclaimed and social-partner, party-political, government-negotiated and regulated activities indicate symbolic policy. That is why it is no surprise that undeclared labour on all levels and under all diverging interests – contrary to publicly expressed protestations – is tacitly classified as completely acceptable and in the end unavoidable.

However, experts are in agreement in estimating the current dynamic of development; they detect a long, continuing increase of averaged turnover of undeclared labour up to 2003 and a subsequent gradual reduction:

- 2003: € 370 billion (€ 140 billion, thus almost 40 % in construction);
- 2004: € 355 billion;
- 2005: € 345 billion.

And likewise of the average share of undeclared labour in the gross domestic product:

- 2003: 17.5 %;
- 2004: 16.5 %;
- 2005: 15.5 %.

## Effects

The transfer of responsibility to the state for the people pushed out of the 'first employment market' has serious consequences for the development of the labour market and social conditions. The insecure employment and living conditions of the



growing number of people who rely on government benefits are weighing heavily on the production and consumption sectors that have not (yet) been made precarious. This tendency affects not only the continued worsening conditioning of active employment, but also the continued worsening reproduction conditions of capital as well.

## Measures

### Agreements and alliances of labour and management in construction

Joint efforts of the social partners in the construction sector to limit undeclared labour (jointly with government authorities) are increasingly suffering from declining membership, in addition to all other problems (that is, the determination, control and prosecution). Currently, about 50 % of the companies with approximately 70 % of the employees still belong to the social partner organisations in construction.

#### *Berlin Declaration of Social Partners in Construction for Combating Illegal Employment*

The declaration made the following recommendations:

- further development of the social security identification card to a chip card, which is to be carried at every job on construction sites;
- establishment of an information alliance among the Federal Employment Office, Customs, social security institutes and Paid Leave and Compensation Fund (SOKA-BAU);
- improving controls at construction sites by means of better data comparison;
- introduction of a general tax deduction procedure for main contractors.

#### *Joint Declaration on Enforcement and Control of Minimum Wages in the Construction Industry*

The declaration of the partners in collective bargaining stated active participation in the enforcement and control of minimum wages. A central commission was planned as level of action.

#### *Alliance Declaration of the Industry-Related Action Coalition against Undeclared Labour and Illegal Employment in Construction*

The action alliance consisting of the Federal Ministry of Finance and the three collective bargaining partners set the following goals:

- raising general awareness of the negative consequences of undeclared labour and illegal employment in the construction industry;
- fair competition under equal conditions instead of ruinous price competition by illegal practices;
- payment of taxes and contributions to social security and to social funds according to the rules;
- complying with minimum wages and the social fund process;
- steadfastness in the fight against undeclared labour that is profit-driven.

The following measures were agreed to:

- strengthening of information to the public;
- improving the local flow of information between the organisations and the Department for Financial Control of Illegal Labour on site;
- support of regional alliances;
- establishment of a working group that meets regularly at the federal level;
- intensification of the Federal Finance Ministry's inspection with a view towards inspecting construction sites, especially before the beginning and end of normal working hours as well as on weekends and current forms of concealment of profit-making undeclared labour.

#### *Agreement on the Joint Fight against Illegal Employment and Undeclared Labour*

Social partners agreed to the following concrete measures and legislative initiatives:

- The social funds of the construction industry should expand their investigation by enterprise and external investigations.
- The preliminary work for specific advice to the Department for Financial Control of Illegal Labour should be improved by forming regional action alliances.
- Formalised notification forms for reporting when undeclared labour is suspected should be used.
- The obligation to carry and present identification papers or alternatively a job card for construction labour should be legally established.

A computer controlled information system – also for data exchange with authorities concerned with tax, social security and social fund questions – is currently being built. The problem of the quantity of data and the development of appropriate filters for reduction to the necessary data must still be clarified.

#### *Networking and improving the notification process*

Recently the different institutes involved in mandatory registration of construction labour – social security, social fund (SOKA-BAU), the Department for Financial Control of Illegal Labour (FKS) and local authorities – have considered whether and how the legally prescribed notification of building sites can be easily linked and compared, taken into account the necessary data protection. The aim is to track down differences in employment figures and financial volume at an earlier stage.

#### *Construction card*

The 'construction card' plays a central role in the current discussion; it appears that all sides want it. However, significant differences arise in the questions of the kinds and quantities of data to be saved, and of expense and supervisory authority.

#### *Gifhorner Model*

This is a municipal plan, primarily with regard to handicraft companies: in cooperation with the district craft association, the district council employs an experienced freelancer in the field, who inspects construction sites every day of the week, around the clock. In the event that infringements are exposed, especially against the Handicrafts

Regulation, monetary fine proceedings are carried out as quickly as possible with the aim of consensus and the renunciation of the right of appeal. Supervision and compliance with instructions by the public authorities are guaranteed.

The model is judged to be successful. It is 'supporting' itself – the freelancer receives portions of the negotiated administrative fines. They can also give advice on making the transition to law-abiding trading and this is viewed as a success.

### *Prequalification*

A model of a Technical Control Association for quality and legality of labour presented by the construction union IG-BAU in 2003 was supposed to identify those building contractors who make correct tenders on the basis of rights and laws, carry out work and deliver results. Such an accreditation would have to be awarded under public law, and permits private and public customers to award work according to compulsory standards, without costly research or bureaucratic expenditures. The recommendation was not implemented.

## Good practices

Commensurate with the problem, the establishment of paritarian employer–employee commissions should be considered in the medium term, which would control and set quality standards under observation of each particular interest, including the professional and protective levels of community planning and tendering procedures, construction health and safety, technology and qualification and so on. In this way, reward systems, certifications and so on could replace latent threats of administrative fines and punishment. For this purpose, it would 'only' be necessary to strengthen the roles of employer and employee organisations in their stabilising cooperation. This would have to be the object of social dialogue. Local authorities, the state and the EU could concentrate on securing publicly transparent basic conditions and safeguarding the government power monopoly and would have to be authorised for fulfilling these tasks.

# The Netherlands<sup>14</sup>

## Regulation and institutions

### Statutory terms and conditions for employees in construction

Mandatory provisions in Book 7 of the Civil Code (which concerns employment contracts) are applicable to all employees and to a certain extent also to cross-border posted workers who are temporarily working in the Netherlands on a foreign employment contract. In addition, labour laws and regulations with a public/administrative law-character are applicable to every employee working either temporarily or permanently in the Netherlands. The most important Acts are the Minimum Wages Act (WMM), the Working Hours Act, the Occupational Health and Safety Act (Arbowet), the Allocation of Employees through Intermediaries Act (WAADI) and the Equal Treatment Act (AWGB). Finally, for all employees who fall back on the Dutch labour market if they lose their job (so, not for cross-border posted workers), protection against unlawful dismissal is regulated in the Extraordinary Decree concerning labour relations (BBA, 1945).

Another important act to mention here is the Obligation to Carry Identity Papers Act, 1993. Article 2 of this Act rules that workers (and in general every person above 14 years old present in the Dutch territory) should be able to identify themselves at the request of the competent authorities. The obligation makes it possible for the authorities to check the identity of workers on building sites in their effort to combat undeclared and illegal labour.

<sup>14</sup> The basic country report was written by Claire Bosse, Tilburg University and Mijke Houwerzijl, University of Nijmegen, The Netherlands. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

## Terms and conditions laid down in (extended) collective agreements

Derogation from legal provisions is often only possible by collective agreement. When a collective agreement provision proves to be inconsistent with mandatory legal provisions, this provision is null and void. For workers who are employed by a non-organised employer in the industry, only extended collective agreements are applicable. The method of extension of collective agreements results in an 'erga omnes' scope during the period of extension, which means that it must be observed by all undertakings in the Netherlands and in the profession or industry concerned.

The main collective agreement in construction is the Collective Agreement for the Construction Industry 2004-2007, covering some 190,000 workers (including managerial, technical and administrative staff) in house, office and industrial building and civil, road and maritime construction engineering. Other major collective agreements are the Collective Agreement for Painters, covering some 35,000 workers, and the Collective Agreement for Plasterers, covering some 17,000 workers.

In addition to the Collective Agreement for Construction 2004-2007, social partners in construction and the temporary agency sector entered into negotiations on the labour conditions of agency workers in construction. In April 2006 this led to an agreement which concerns some 3% of the total workforce involved in construction. The main principle is that the agency has to pay the agency worker the same wage as employees of the user enterprise with the same or a comparable type of job. A distinction is made between starters (agency workers without previous working experience in construction) and so-called skilled workers (agency workers with more than a year's experience and/or a diploma in construction). Next to the provisions on wages in the collective agreement for construction, the last group is also entitled to extra holidays and some other fringe benefits regulated in this collective agreement.

Finally, the social partners in both sectors agreed upon more cooperation, which should ensure, among other things, strict compliance to the new rules by temporary work agencies. This recent agreement will be formalised in new collective agreement provisions in both the Collective Agreement for Construction 2004-2007 and in the collective agreements of the temporary work agencies sector. When these are declared universally binding, a level playing field will be created in labour conditions for all employees working in construction, whether they have a contract with the user company, with a Dutch or with a foreign temporary employment agency.

## Licences and other building regulations

Since 2001, registration in the trade register is compulsory for almost every company, but no diplomas or permits are required. In construction and allied trades no special conditions have to be fulfilled to start up companies offering basic activities such as handyman services, painting or pointing, making furniture, carpentry (with a non-'constructive' character). If someone wants to operate as a self-employed worker in these activities, they only need to register at the Chamber of Commerce (trade register). But to start a company as a building contractor, in civil and utility construction, bricklaying, demolition, carpentry (for more complex constructive works), civil, soil and hydraulic engineering or in the services installation sector (electro-

mechanical services, gas and water fitters, plumbers, central heating, air-conditioning and cooling, greenhouse heating), an establishment permit is required according to the Establishment of Companies Act. To run these more complex companies, which place extra demands on the entrepreneur, a business diploma is required.

### Liability regulations (fiscal, social contributions, labour conditions)

Since 1982, the Wages and Salaries Tax and Social Security Contributions Act (Liability of Subcontractors – *Wet Ketenaansprakelijkheid*) provides that the main contractor is liable for social security contributions and income tax. The first goal of this Act is to fight unreliable subcontractors. The main contractor is liable for the whole chain of subcontractors who follow in line and are at work on the same project at the building site. The second goal is to combat unfair competition. However, when foreign subcontractors are at work with posted workers, no social security contributions and income taxes are due for the first 183 days of work.

With regard to labour law, Art.7:658 (4) Civil Code provides for a liability of the user undertaking in the event of industrial accidents or work related diseases.

In addition, the Collective Agreement for Construction provides that: “The employer is obliged to monitor the compliance of the provisions of this collective agreement in all individual employment contracts covered by the agreement. When dealing with independent entrepreneurs, the employer should agree on this in the subcontracting arrangement.” (Art. 94).

### Other relevant legislation and regulations

Several laws deal – either directly or indirectly – with undeclared labour. The Act on fines, measures, reclamation and recovery related to social security is directed at preventing people from providing undeclared labour while receiving disability or unemployment benefit.

The Alien’s Act and the Foreign Nationals (Employment) Act (WAV) are also important. These Acts are directed at preventing illegal residence and work in the Netherlands. If an employer employs a foreigner without a work permit (illegal labour) this is considered an economic offence.

In 1998 the legislation on temporary work agencies was altered, abolishing the system of permits for agencies and the maximum tenure of the agency worker with the user company. Next to this, the authorisation procedure and most sector restrictions for agency work were abolished. This was laid down in the Allocation of Employees by Intermediaries Act, 1998 (WAADI). The WAADI regulates the position of intermediaries, including employment agencies. As a result there are very few requirements for temporary employment agencies.

### Role of the Labour Inspectorate

The Labour Inspectorate (department *Arbeidsmarktfraude*) runs a nationwide inspection programme against labour market fraud aimed at compliance of the

Foreign Nationals (Employment) Act. In 2004, the number of inspectors was raised from 100 to 180. Controls are focused on temporary agencies, agriculture, construction, hotels and catering, and meat and fish processing. Moreover, control of private individuals performing illegal (undeclared) work in areas such as the renovation or painting of private houses was intensified. Since 2002, the Labour Inspectorate has cooperated closely with other authorities in so-called Building Intervention Teams. The teams visit construction sites to check if illegal employment, moonlighting, bogus-self-employment and other forms of fraud are taking place.

## Other authorities or institutions involved

### *Tax authorities*

From 1st January 2006, the Tax and Customs Administration is responsible for levying and collecting not only income tax but also social security contributions. Combating fiscal fraud is delegated to the Fiscal Intelligence and Investigation Department – Economic Investigation Service (FIOC-ECD).

### *Social benefit institutions*

Several public authorities deal with the problem of social security benefit fraud. The Social Insurance Bank (SVB) is an independent administrative body, responsible for the implementation of social security schemes for various government agencies. UWV (a body implementing employee insurance schemes) is responsible for the control of the Unemployment Act and the Occupational Disability Insurance Act. The Social Information and Investigation Service (SIOD) operates under the responsibility of the Ministry of Social Affairs and Employment and concentrates its efforts on major fraud, illegal employment and so on. Both the Labour Inspectorate and UWV work on the basis of concrete complaints and hints, increasing the effectiveness of their controls. Complaints are either made directly to them or passed through by employers' and workers' organisations. The trade unions have a complaints desk to gather complaints on unfair competition by illegal construction workers.

## Nature and features of undeclared labour

### Definition

The definition of undeclared labour used in the EIRO thematic feature on undeclared work (2004) was as follows: "Undeclared work can be defined as any paid activities that are lawful as regards their nature but not declared to the public authorities." Twenty EU Member States were involved. A report from SEOR (Socio-Economic Research Rotterdam) also refers to two categories or divisions for the market of personal provision of services: "formal – informal" and "undeclared – declared – unpaid (voluntary)" forms of labour. The most dominant context in which the label 'undeclared labour' is used nowadays is that of illegal labour. In practice, illegal labour involving migrants without a residence and/or work permit, and undeclared labour are often combined.

## Different forms

The majority of the workers involved are domestic students, unemployed people, the self-employed and employees moonlighting on top of their normal jobs. In these sectors, there is also a high incidence of illegal foreign employment: in 15 to 25 % of the inspected companies, the Labour Inspectors found illegally employed foreigners. Undeclared labour accounts for 15 % of the total construction market, or € 2.7 billion a year.

A study by the Economic Institute for the Construction Industry (EIB) commissioned by BouwNed showed that 30 % of all household renovation and maintenance jobs for which a building licence is issued are not performed by registered contractors. The Institute calculated that, as a result, the industry lost more than € 1.8 billion and 15,000 man-years of work in 2003. According to former EIB director Adri Buur, this is only the 'tip of the iceberg'. The real loss is much higher because EIB only investigated part of the market. These results are in line with the results of an inquiry by SEOR published in December 2004 on the size of the market for personal services. Researchers of SEOR found that 44 % of all small jobs in private households are performed informally. Moreover, they found that specialist jobs are mostly performed by registered building contractors, while small or simple jobs are often left to illicit workers.

Finally, an internet inquiry by HDC Media confirmed that more than 50 % of the Dutch make use of undeclared labour. Eighty-five per cent of the interviewees did so because of lower labour costs; only 10 % because legal workers was not available. Renovation was on top of the list of odd jobs for which undeclared labour was engaged.

In this report we distinguish between undeclared labour (also called undeclared employment) and illegal foreign employment by workers without a work permit and often also without a residence permit.

## Extent

According to EU figures, undeclared labour accounted for 13.8 % of the Dutch Gross National Product in 2002, which was about the EU average. The bulk of undeclared labour takes place in agriculture, construction, hotels and catering, cleaning, and meat and fish processing.

In a 2005 study on compliance with the Foreign Nationals (Employment) Act, Regioplan pointed out that 28 % of the employers in construction engaged illegal workers, compared to 19 % of the employers in general. Employers entered into 267,000 employment relations with foreigners who were without a work permit. These relations involved 66,750 to 98,000 foreigners who worked 44,500 to 66,750 work years. This is between 0.8 % and 1.2 % of the legal work volume. This volume excludes the illegal employment with private persons as employers (they were excluded from this study).

Following ongoing rumours, the Labour Inspection visited construction sites and private households to check the employment of foreigners without work permit. The inspections were held between 1st March and 15th December 2004 and produced the following figures: illegal employment was involved in almost half of the building



activities by private households. Approximately 20% of the inspected building companies were not abiding by the Foreign Nationals (Employment) Act. The Labour Inspectorate received 136 hints of suspected illegal employment: 123 from outside, 12 from the UWV and one from the tax authorities. In 2002, the Labour Inspectorate visited 99 building sites and found illegal employees on 45 of them. About half of the 129 workers concerned came from Poland.

## Functioning of the undeclared labour market

### Actors

In recent years, illegal foreign employment has become a popular topic in the media. Illegal foreign workers not only compete unfairly with registered companies; they also constitute a threat for Dutch workers engaged in some form of undeclared labour. They commit a double offence: not only do illegal foreign workers evade taxes and social security contributions; they also work below the price of national undeclared workers, preventing them from gaining an extra income besides their formal employment.

This picture is confirmed by Bob Strang (UWV): the UWV discovered that Polish and other foreign odd-jobbers push their Dutch colleagues out of the market. Nowadays social security fraud by Dutch citizens is difficult to detect because the traditional areas of undeclared labour are taken over by the Polish, while the Dutch concentrate their efforts in and around private houses where they are difficult to control. In our interview Strang explained that UWV was in a “process of reorientation”, because they have lost their target group out of sight. Recent figures from the Ministry of Social Affairs and Employment (the so-called POROSZ inquiry) revealed that the number of benefit recipients committing fraud has stayed more or less the same compared to the first inquiry in 2001. These figures are based on information given by the benefit recipients themselves, which means that in practice the extent of fraud is probably much higher. Asked for the number of benefit recipients and the number of people committing fraud, Strang gave some rough estimates based on the latest POROSZ inquiry issued in 2004: in the Netherlands, some 400,000 people receive unemployment benefits while another 800,000 to 900,000 people are on disablement benefit. Between 80,000 and 150,000 beneficiaries are involved in undeclared labour.

Almost all Polish construction workers are engaged through temporary employment agencies or intermediaries based in Poland, Germany or the Netherlands. Most Polish self-employed persons offer their services to private households (small jobs in and around private houses) without an intermediary, building up their own network of clientele. However, a growing number of intermediaries and temporary work agencies try to penetrate the market for private renovation and maintenance jobs, some of them in bad faith. Often constructions are semi-legal: a migrant worker is on the payroll for the statutory minimum wage per month, which is based on a 40-hour working week. In practice the migrant worker works more than 60 hours per week, which decreases his wage per hour substantially. Another popular practice is to

pay at a regular wage level, but to deduct costs for tools, working clothes and so on from the wage, because everything that is needed to get the work done has to be hired via the intermediary.

## Segments

When looking at the four patterns of undeclared labour distinguished by CLR, in the last five years type A (Informal individual, own account) and C (Informal undertakings) are clearly on the rise in private households when performed by illegal migrant workers. More and more Polish workers (bogus or really self-employed, undeclared or declared) are hired for renovation and painting of private houses. The Polish workers leave notes in the supermarket or drop them in mailboxes, or advertise in local newspapers. New customers also come in by word of mouth.

As was mentioned above, figures from the Ministry of Social Affairs and Employment (the POROSZ inquiry) indicate that the number of benefit recipients committing fraud (or type B: Moonlighting – irregular next to regular) is more or less stable. The trend is to insure employees only during regular working hours and during home-work travelling time against accidents and disability. This means that accident risks during moonlighting are often not insured anymore, which makes it less attractive to go on with undeclared activities. Sick leave prevention is also becoming stricter these days, which makes moonlighting during working days, while officially on sick leave, less easy.

According to the compliance authorities involved, the amount of undeclared labour in the lower stratum of the pyramid of subcontracting (type D) is significant, although difficult to quantify. Especially when the chain is longer than three to five subcontractors, there is a high risk that the chain ends up in a grey zone with the result that part of the official site work becomes undeclared. In the beginning and at the end of the project (illegal) migrant workers are used most frequently. These are peak moments for unskilled and/or more basic tasks. The more complex jobs in the midst of the project are done by regular workers.

## Reasons

The main reason for undeclared labour in the industry is the financial gain: the evasion of income taxes and social security contributions results in considerably lower labour costs, offering a competitive advantage compared to law-abiding employers and workers. The evasion of taxes and social contributions often goes together with failing to respect minimum wages, collective labour agreements, safety regulations and so on, which makes undeclared labour even more profitable.

A second reason (partly connected with the first one) is overregulation. Construction activities are regulated by a set of complex and ever changing rules. This makes it difficult to obey them, especially for small undertakings where the employer does not have the necessary knowledge or personnel to provide for administration, bookkeeping and keeping up with new regulations and developments in the sector. This explains the higher incidence of undeclared labour in small and medium sized

enterprises. Not only employers and workers, but also the controlling authorities themselves, seem to suffer from the complex regulation in the construction industry.

Ignorance among employers and workers is a third reason for the existence of undeclared construction work. Private households are often unaware of the impact and risks of employing informal workers (both nationals and foreigners) for small jobs in and around the house. This kind of ignorance goes together with a high degree of tolerance or acceptance of informal practices. Everyone is and has always been engaged in some kind of undeclared labour, as one of the interviewees said.

The low risk of being caught is the fourth reason. The (perceived) risk of inspection and the (perceived) risk of detection both influence the behaviour of employers. The risk of being caught is estimated at only 1% for unemployed and disabled persons entitled to a benefit. In the case of illegal employment of foreigners, the risk of being caught is estimated at 5 to 10%. Research commissioned by the Dutch Association of temporary work agencies (ABU) suggests that the degree of control in construction is so low that the risk of being caught is next to nil.

A final reason to use undeclared labour is the lack of availability of regular employees at a certain place and for a certain time. In this case, an employer might consider to employ (or otherwise engage) foreign workers for a specific project. However, when procedures are time-consuming and regulations are complex some employers might look for faster and easier ways to have the work done. The availability of illegal temporary workers makes them difficult to resist using.

Big companies concentrate more and more on management and organisation of building projects, which means that they employ more staff and fewer operatives. For every project, workers are hired from specialised subcontractors on the basis of temporary contracts. The subcontractors employ other subcontractors, but also Dutch or Polish self-employed workers. One of the interviewees explained that undeclared labour is a common practice among subcontractors at the end of the building process. Due to time pressure, chains of two, three or more subcontractors are engaged to deliver the project just in time. The longer the chain of subcontractors, the higher the risks of undeclared labour as margins are getting smaller. At the end of the chain, undeclared labour is almost inevitable.

## Dynamics

BMT Consultants conclude in a study called 'Foreign workers and self-employed persons on building sites' commissioned by the union FNV Bouw that labour relations at construction sites have changed over the last couple of years. There appears to be an increase in the number of self-employed, posted workers and temporary workers from abroad. This could explain the fact that both in 2004 and in 2005, an increase in production was accompanied by a slowdown in employment. In 2004 production increased by 1.2%, whilst employment decreased by 5.2%. In 2005, production increased by 2.5%, whilst employment for workers decreased by 3% and employment for self-employed persons increased by 1%. The year 2005 was especially bad for employment in services installation, finishing and in maintenance: a decrease by more than 4%.

Since 1998, the number of dubious temporary employment agencies has risen sharply, which might at least partly be due to the abolishment of the permit system. Other reasons behind the considerable increase in agencies using illegal employees and/or evading the payment of taxes and contributions are the more stringent legislation to combat illegal residence and the thriving economy of a few years ago. According to an investigation of the association of temporary work agencies (ABU) in 2004 the number of organised branches (companies) was 3,000, whereas the number of dubious branches was 6,600. The number of temporary workers through bona fide placement was 650,000, whereas from an estimated number of 210,000 illegal workers in the total workforce, 100,000 of them were temporary workers through fraudulent placement. Both the government and the sector now take measures to fight the illegal activities.

The number of self-employed persons has risen sharply since the 1990s. An important measure in this respect is the lifting of the ban on temporary work in construction. Self-employment became even more popular when labour brokers left the scene and entrepreneurship was promoted by the government. On the 1st of January 2004, 1,262 Polish companies were registered. Apart from this, there are also foreign registered companies and self-employed persons active on a temporary base. These self-employed persons or companies are not subject to Dutch taxation, if they stay less than 183 days. So, there is an unknown number of entrepreneurs not registered and thus not included in national statistics.

Interviewees confirmed that there is indeed a relationship with the economic cycle; recessions leads to more undeclared labour. Over the last two years the Labour Inspectorate received more complaints and hints than ever before. Due to the economic recession, there are fewer jobs available at private households and people are more inclined to choose cheap solutions, such as the engagement of Polish plasterers and painters instead of registered contractors.

## Measures

### Integrative approach

The following integrative policy proposals or measures have been identified:

- a. proposal for the removal of (administrative) disincentives and simplification of procedures;
- b. proposal for the reduction of VAT and/or positive incentives for employees in the tax and benefit system and/or reduction of non-wage and/or social security costs;
- c. differing views and proposals on free movement of labour;
- d. Declaration of Independent Contractor Status: to tackle the issue of bogus self-employment, the Dutch Parliament passed this Declaration. The Act came into force in January 2002 and was amended in January 2005.

### Enforcement approach

In recent years, the focus seems to be shifting from regulation to suppression through increased controls and fines. This is accompanied by stricter policies towards people

staying illegally and towards asylum-seekers. The main focus is on:

- better enforcement of existing laws and conventions and improvement of control;
- more staff and resources for the labour inspectorate and other authorities or institutions involved;
- higher efficiency in penal or administrative procedures, and sanctioning of all actors;
- blacklisting of contractors and/or customers;
- internal discipline (including ban) in the social partner organisations;
- job cards or other employee registration methods;
- deduction of tax and social security contributions;
- other methods linked to the liability in the chain (main contractor and/or client);
- improvement of the cooperation between actors concerned.

During the research the following measures were highlighted:

- a. cooperation of authorities in Building Intervention Teams: the fact that more than 70 inspectors from different institutions operate simultaneously has certain advantages. This will prevent the concealment of offences: if the labour inspectorate operates without the tax authorities (or vice versa) certain offences will be hidden as soon as the inspector leaves the building site. Another advantage is that a combination of different sanctions and back payments “really hurts”;
- b. more labour inspectors: the number of inspections will gradually increase from 3,900 in 2003 to 10,500 in the year 2006. New inspectors are trained to control the observance of the Foreign Nationals (Employment) Act;
- c. measures to report new employees from the first day of work;
- d. recommendations by the trade union federation;
- e. complaints desk;
- f. billboards;
- g. ongoing debate on combating illegal practices in the temporary agency sector.

Upcoming is a joint initiative for a ‘Compliance Office Construction Industry’. From 1st July 2006 on, a so-called Compliance Office (Bureau Naleving Bouwnijverheid) combats illegal employment and unfair competition by migrant workers. Its aim is to actively monitor compliance of the rules by foreign companies and (their) workers. The Office has to become a central point of contact and registration for employers and employees and will actively search cooperation with Labour Inspectorate and other enforcement authorities and with the social partners in the temporary agency sector to join forces against concrete illegal practices.

### Promotional approach

A third approach can be characterised by initiating awareness-raising campaigns that focus on the positive benefits of regular, declared work. Some examples include:

- a. information events in the regions;
- b. media campaigns;

- c. unionisation of illegal workers;
- d. information on most important labour conditions in the construction industry.

### Future plans concerning the free movement of workers from new Member States

By the end of March 2006, the government announced that from January 1st 2007 onwards, the Netherlands will allow free movement for workers from Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, Slovakia and the Czech Republic. These workers with the nationality of the new EU-Member States would be given unrestricted access to the labour market and they would be entitled to the same treatment as Dutch workers. According to the cabinet, freedom of movement for workers is inevitable and further postponement would lead to an increase in the number of self-employed from the new EU-countries and an increase of the number of illegal practices. The government announced a number of measures first to prevent unfair competition:

- The Labour Inspectorate will be authorised to impose direct fines on employers who fail to pay statutory minimum wages.
- In the future, the Labour Inspectorate will also notify workers and trade unions of cases of infringement of the Law on minimum wages, which will facilitate taking matters to court to demand back payment. By passing on information trade unions can better enforce observance of Collective Labour Agreements.
- The Tax Department and the Labour Inspectorate will cooperate more closely to counter illegal labour, undeclared employment and migrant workers posing as self-employed workers without personnel to evade statutory minimum wages.
- To combat fraud in tax on wages and social security contributions, agreements will be made about the proper exchange of information between the competent bodies in the Netherlands and other EU-countries.
- Government will support information campaigns initiated by employers' organisations and trade unions, to raise awareness among workers from the new EU-countries on Collective Agreements and minimum legal conditions of employment.
- The cabinet will also support certain municipalities in combating unsafe and illegal housing situations.

Parliamentary debates on the issue in April 2006, however, revealed broad opposition to the plan. The cabinet has postponed a final decision on the opening of the labour market until the end of 2006.

## Good practices

The following initiatives are put forward as good practices to combat and/or prevent undeclared labour in construction, although their impact is still difficult to measure:

1. The coordinated approach of enforcement institutions within Building

Intervention Teams is appreciated by interviewees as a good (or even best) practice.

2. Media campaigns and press releases of the Ministry of Social Affairs and Employment are important initiatives to inform the general public on the negative effects of undeclared labour.
3. Information on legal employment of foreign construction workers is offered by Bouwend Nederland.
4. To tackle the issue of bogus self-employment, the Declaration of Independent Contractor Status seems to be a valid initiative.
5. A promising initiative is the Compliance Office established by the social partners with regard to the enforcement of collective agreement provisions.

# Poland<sup>15</sup>

## Regulation and institutions

The Labour Code is a specific constitution of work relations in Poland. It defines general conditions in which labour can be recognised as illegal, the basic principles of control and supervisory institutions, and the proper judicial procedures for labour relations. The new Act for the promotion of employment and the institutions of the labour market is, among others, an attempt to cope with new phenomena in the labour market: structural unemployment, high unemployment among young people, a low level of professional activity, the shadow economy and illegal employment. One can recognise that this Act is an attempt to implement an active employment policy. The Act for the employment of temporary workers was intended to add flexibility to the labour market. However, some gaps in this and the previous Act (among others, in the range of functions of employment agencies) require changes to shore up the system. The Act relating to foreign employment regulates the employment of citizens of other states in Poland. The new Act on the freedom of economic activity is important and can be used to analyse the regulations for self-employment.

## Services for inspection

In general it can be said that there is weak or limited cohesion and coordination between the different inspection services. The services for the inspection of legality of employment base their work on the Act for the promotion of employment and institutions of the labour market (Art. 116 of the Act). These services are supervised

<sup>15</sup> The basic country report was written by Jakub Kus, researcher and secretary Budowlani, Warsaw, Poland. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).



by 'voivodes' (local regions) and Title 20 of the Act defines the principles of inspections.

As part of its range of tasks, the State Labour Inspection controls the legality of employment through policing labour contracts. This includes ensuring that employers observe employment law, in particular the regulations for health and safety and at work, regulations relating to employment contracts, payment for work and of other benefits resulting from this work, hours of work, holidays, maternity and paternity rights and the employment of young and disabled people. All of these areas have an influence on the evaluation of the workplace. Infringement of the regulations relating to these areas in many cases means that people will be engaged in undeclared labour.

### The Border Guard

The Border Guard controls the movement of people and the flow of goods through the Polish state borders. It grants permission to cross the border and issues visas. In this capacity it can check that a foreigner's visit complies with the stipulations of their visa. A considerable number of people on tourist visas issued to citizens of Ukraine, Belarus, Armenia, Vietnam, Romania or Bulgaria work or trade illegally. The statistics gathered by the Border Guard allow for an approximate estimation of the size of the phenomenon of the labour migration from third countries. The border movement of people in 2005 increased in comparison to 2004, particularly along the border with Ukraine (about 47%) and reached 17,753 crossings of the border. Of course this number includes people other than citizens of Ukraine, illegal workers and persons earning their living from the shadow economy. However, the growth of the number of border crossings increases the group of illegal workers looking for employment in Poland and other EU countries.

### Other institutions

From 2003 the Customs service has been authorised to control the legality of foreign labour. The service acts according to statutory regulations. It cooperates with the tax inspection regimes set out in the framework of voivodship (or regional) treasury boards. It also cooperates with the police.

The offices of the treasury are responsible for ensuring the fulfilment of the tax obligations. The so-called treasury police have very wide powers. However, these only relate to undeclared labour to a small degree.

The Institution of National Insurance (ZUS) acts according to the statutory regulations of social insurance and manages the compulsory social insurance contributions paid by companies and workers. ZUS employs over 1,500 inspectors. It executed over 98,000 controls in 2003 with 78,000 taxpayers and identified 63,730 breaches, including a lack of social and health insurance for 14,500 workers. The ZUS Inspectors prepared 2,889 motions to the courts, police, prosecutors, health insurance institutions, labour inspection, treasury control chambers and labour offices. The database of ZUS should be the basic source of information about the amount and types of undeclared labour, but ZUS statistics have been difficult to access until now.

## Nature and features of undeclared labour

### Definition

Actors in the construction sector – social partners as well as public institutions dealing with matters of the industry – most often use the notion of the ‘shadow economy’. It encompasses an illegal or hidden production of materials and articles, an illegal or undeclared provision of services, and undeclared and/or illegal provision of labour. It means that undeclared labour concerns both undeclared labour (undeclared to the tax, statistical, insurance and customs authorities) and illegal labour (work conducted by people without proper qualifications). However, it seems inappropriate to use the term ‘criminal employment’ because these infringement of legality of employment are not a subject of the Penal Code – infringements of the Code in the area of employment in the construction sector are very rare. The common term for undeclared labour in construction is work in the ‘shadow economy’. This means employment without an employment contract, no payments of tax and social security obligations connected with the employment of the worker, and no payments of other obligations connected with the non-wage labour costs. It also means, in the majority of cases, that salaries are paid in cash (for example, daily pay or payments for tasks completed).

At present studies of undeclared labour focus, almost exclusively, on unregistered labour or unregistered employment. This is undoubtedly because of the significant difficulties in measuring the volume of legal undeclared labour and in evaluating the phenomenon of bogus self-employment. Legal undeclared labour is when the ‘payment’ for the work done (usually conducted as ‘neighbourly help’) is other work which is provided as an equivalent compensation.

Unregistered labour is considered as hired work provided without an employment contract, a civil law based contract, a task contract or any other written contract between the employer and employee. Workers undertaking unregistered labour are not entitled to national social insurance. Social insurance contributions for the period of this unregistered labour do not count from the point of view of Social Security, and the employer does not transfer appropriate sums from paid salaries to the account of Social Security and the Work Fund. Personal taxes are not paid from the income received from unregistered labour.

Self-employment is also considered as unregistered labour if a person does not fulfil their economic activity financial duties toward the state (for example, taxes). This definition has been applied to this study, except where specific conditions in the construction sector necessitate a broader or more precise definition.

### Different forms

Assessment of the scale and types of undeclared labour in the construction sector, according to commercial and professional organisations, leads to the thesis that the majority of undeclared labour is short term and seasonal in character. Some undeclared labour, which takes place continuously, concerns full-time workers receiving payment in cash for undeclared hours of labour, in addition to their official

pay. Only for less qualified groups of workers (unemployed people performing unregistered seasonal work) and for workers in rural areas is undeclared labour the basic kind of employment (and main source of income). Even for these groups work in construction is only one of many sources of undeclared income for the individuals involved. The situation is different for immigrant workers: for them, undeclared labour is the main and only source of income.

Construction activity in the rural areas is based on unregistered labour to a large extent. A considerable part of rural communities function in an autarkic way in many spheres. A closed economic circle exists, in which someone produces basic construction materials (officially for own use, but in fact for sale), someone organises a building group (often with good qualifications) and someone organises transport. Investments in construction on farms are therefore realised without paying taxes and other social and health insurance obligations. Salaries take into consideration the prices on the local market. EU membership indirectly made a contribution to the growth of undeclared labour volume in the rural areas: a significant part of the direct supplement payments for agricultural activity is devoted to building investments (houses and household buildings) which are performed by the undeclared workforce.

## Extent

The services for inspection mainly carry out intervention inspections and have the duty to inform proper institutions. In 2004 and 2005 inspections detected respectively 15.5 % (24,074) and 23.9 % (20,792) cases of illegal employment. According to the data of the Ministry of Labour and Social Politics approximately 30 % of economically active citizens violate employment regulations. There were 517 construction companies among 4972 cases in which infringements of the employment regulations were detected. There were 1229 cases of people being employed without an employment contract or without declaring their employment to social security (708 of these were registered as unemployed), and another 1424 cases of work by unemployed people who did not inform the local labour office. There were 33 cases of illegal employment of foreigners detected. Considering the realities described by organisations of employers, this last number testifies to the inefficiency of inspection in this area. It is difficult to measure the effectiveness of inspection because there is only a very limited number of inspectors.

Similarly, as in many different European countries, sources of information about the scale and character of undeclared labour are limited. Estimations of the share of the grey economy in GDP vary from 14.6 % to 27,4 %. The main statistical office has limited data which means that it is only possible to estimate the scale of the phenomenon. The most important (and practically only) studies on the subject of undeclared labour were prepared within the framework of studies of economic activity of the population (BAEL) in 1995, 1998 and 2004. In 2004, BAEL was carried out in 18,900 households, in which interviews with 47,200 persons aged 15 years and over were carried out. The module study included 23,700 respondents, and 21,100 (that is 88.9% respondents) answered the questions in the questionnaires. Unregistered labour is a widespread phenomenon. From January to September 2004, 1,317 thousands

persons worked in the shadow economy and it was used by 1,019 households. Compared with 1998 the number of persons working in the shadow economy decreased, but at the same time the rate of employment in the economy increased from 9.3 % to 9.6 %. The number of persons working illegally in the countryside and in cities was divided equally, which means that farms in the countryside employed unregistered workers almost twice as often.

## Functioning of the undeclared labour market

### Actors

Clients of undeclared labour in the rural areas are private owners of bigger farms and plantations. The problem concerns both skilled workers and the employment of unskilled unemployed persons.

In the case of construction works undertaken in rural areas, the actual ordering and recruitment is based on internal bonds between the local community members. Residents of a given locality, and sometimes even a larger area, know very well who provides what services and what skills they possess. This network is largely stable and does not require any intermediaries.

Meeting points for unemployed people, usually around the neighbourhood employment office, often function as sources of recruitment of poorly qualified workers for incidental work. Such a system of recruitment has a long history from the previous system, and it has survived, particularly in smaller municipal centres. The points of recruitment activate particularly during periods of seasonal work and provide a direct contact between an employer and workers recruited for a very short period.

Companies hiring unemployed persons as undeclared labour are both employers from small and medium-sized companies which operate 'at the margins' and, in principle, legally formed medium-sized companies searching for bigger groups of workers for less qualified tasks and short-term, urgent labouring jobs. In this case it is mainly illegal agents who recruit workers. This concerns all kinds of construction (except repairs and finishing jobs in dwellings). Unemployed skilled workers are recruited individually, while unskilled workers are recruited in groups.

The role of informal networks and illegal intermediary agencies is difficult to examine. The activities of employment agencies, temporary employment agencies, and temporary workers are regulated by law. Recruitment of qualified workers in the construction sector takes place mainly in the temporary employment agencies. The problem is, however, the growing number of intermediaries active in the shadow economy, creating informal and also supranational connections. These networks and agencies, intent on maximising their profit and not observing any employment law regulations, simultaneously exploit the weakness of inspection services and use official databases, created for other purposes by different public and private institutions, to recruit workers to the shadow economy. This activity is entirely outside the law. One should underline that the functioning of these networks is possible because a certain number of employers accept using undeclared labour. They provide intermediaries with offers of illegal employment knowing that this violates employment law. The

setting up of intermediary agencies for immigrant worker employment is in practice completely illegal. The majority of them are networks based on the activity of citizens of Ukraine, Armenia and Belarus residing in Poland and cooperating with Polish citizens. The activities of these illegal networks/agencies are aimed not only at worker recruitment but also at transport and visa arrangements. There is a cross-border activity through individual intermediaries acting in the well-known contact points (railway and bus stations).

## Segments

According to the opinions of employers and chambers of commerce, the phenomenon of unregistered labour occurs in all subsectors of construction, although not to the same degree and scale. Most often the phenomenon of undeclared labour occurs in the sector of maintenance and repairs, and in individual housing projects. Undeclared services in these subsectors are provided by small and one-person companies. There is a different type of undeclared labour in the subsectors of multi-family housing projects and industrial, infrastructure and road construction. Here, a larger group of workers can find work and their recruitment is done in a more organised way.

The largest share of undeclared labour occurs in the sector of small and medium-sized private companies. The public sector (state and municipal), which makes up a small fraction of construction companies, in principle does not use undeclared labour. As a rule foreign companies also do not use unregistered workers. However, under Polish conditions, they use services of a long chain of subcontractors, among which there are often companies on the border of the shadow economy. An analysis of the market shows that undeclared labour in construction is most often used by households for services installation and also for basic construction works (possibly a majority of construction services in rural areas is done in the shadow economy). According to employers it is also used often in cases where its value is very high, particularly for servicing specialised equipment. In this case, companies and operatives providing services for other contractors accomplish this work during undeclared working time.

It is possible to distinguish two groups of construction occupations in which undeclared labour is employed most often. In the first group are occupations requiring people who are highly qualified: workers doing finishing works such as plumbers, electricians and engineers. Bogus self-employment also occurs quite often in this group. Here, declared labour is undertaken alongside undeclared labour so that some taxes and social insurance contributions are paid and some part of the overall salary is official. Operators of special construction equipment are included in this group.

The second group are workers who are poorly qualified. They are employed through illegal or half-legal agencies, or through subcontractors which are in reality only a structure intermediating in recruitment of unregistered workers. This includes registered unemployed people who receive benefits. Here, unregistered labour is provided in its pure form, operating fully in the shadow economy.

People who are registered as unemployed make up the main group of undeclared workers in the construction sector. By not notifying the authorities about their

employment they violate the law. However, in this way they maintain their right to health insurance and other benefits. Most often they perform tasks that do not require them to be highly qualified and work in the sector only in the high season. They are not a stable workforce; because of low salaries they often change their place of work. There is a group of highly qualified unemployed construction workers that are not looking for employment on the labour market and take up better paid work in the EU countries, most often without declaring this fact to the Polish employment offices even if the work done in another country is legal.

A majority of undeclared foreign workers comes from neighbouring countries that are not members of the EU, primarily from Ukraine and to a smaller degree from Belarus. These workers provide illegal labour in Polish-registered construction companies, but they are also employed in companies acting fully in the shadow economy (that is, unregistered businesses). The majority of these workers crossed the border with tourist visas and are therefore not allowed to work. These people try to renew their visas every three months, a comparatively easy task because of the facilitation in the movement of people between Poland and Ukraine. Illegal labour immigration from other countries is not significant, although workers from Armenia, Kazakhstan or Romania also work in the sector. Some importance should also be attached to the inflow of illegal workers from the countries of the EU, mainly managers and middle-level technical supervisory personnel who ignore the regulations concerning the employment of foreigners.

A number of illegal foreign workers are students. As a rule they perform work that does not require specialist qualifications. The situation of people with tourist visas is considerable, but difficult to estimate. This group consists of experts or persons with higher education above the required qualification (engineers performing work of qualified workers).

Currently, qualified foreign workers are particularly sought after for occupations such as bricklayers, steel fixers and concrete layers, construction carpenters, and fitters, electricians, plumbers, and fitters of heating and ventilation. An absence of officially recognised certificates of professional qualification is not an obstacle to employment.

## Reasons

The level of undeclared employment in the construction sector is connected with many socio-economic factors. Establishing a hierarchy of these factors is essential for defining an effective policy to limit this phenomenon. Self-employed people and small construction companies constitute approximately 98% of the workforce of the construction sector. Undoubtedly, according to the main organisations and actors working in this sector, this is the sector of the economy where the phenomenon of undeclared labour occurs most often. In the opinion of employers, chambers of industry and commerce, and trade unions, an economic recession and a decline in investments in the construction sector undoubtedly causes growth of the shadow economy, and also of unregistered employment. This was the experience of the recession period from 1999 to 2003. However, it is hard to say that a construction boom limits this phenomenon. It is not supported by studies of undeclared labour

carried out by CSO (GUS) in 1995, 1998 and 2004, among a control group of households as part of the Framework of Studies of Economic Activity of the Population (BAEL).

There is no doubt that the level of obligations resulting from the non-wage costs of work (taxes, national social insurance, costs of implementing safety at work) has a direct influence on the rate of unregistered employment, in correlation with the effectiveness of penalties for infringement of the law in this area, and with the effectiveness and the scope of controls. Relatively low effectiveness of these penalties, a lack of coordination of activities by supervisory institutions and a disintegration in economic activity in the construction sector mean that this phenomenon is likely to continue, leading to profitability for customers/investors, employers and workers.

Another factor fostering a high level of unregistered employment in the construction sector, despite changes in the past years, is the public procurement tendering process failing to recognise unrealistically low labour costs being submitted as part of bids.

The absence of a generally recognised minimum wage in the sector is acknowledged by trade unions and some employers' organisations as a particularly important obstacle in fighting unfair competition in the construction sector. This means that it is possible to provide very low costs of labour in the tender procedure, and the commissioning party is not obliged to pay attention to the fact that the level of wages set out in the bid does not allow for legal employment of workers in appropriate positions.

It does not directly result from public procurement law (or other legal acts) that the general contractor is simultaneously responsible for observing the legal employment law and the regulations regarding taxes, salaries and social insurance by subcontractors. According to the opinion of organisations active in the sector and of inspection authorities, it happens because, in the 'subcontractors' chain', the last links function partially outside the system of legal employment.

Besides work provided according to the labour legislation, it is recognised that there are contracts for performing a certain task, and commission contracts regulated by the civil law. An analysis of economic practices shows that the principles of a 'contract' for performing a certain task are quite often abused in the construction sector (this kind of contract does not require the employer to pay certain non-salaried expenditures connected with the costs of social security).

The problem of self-employment is of special importance. A great majority (more than 90%) of the workers in the construction sector are self-employed. In the years 1999-2003, a period of recession in the construction industry, many workers were forced to register their own economic activity (as self-employed). But the independence of many of these workers was (and still is) bogus. This registration was intended to avoid their employer paying the non-salaried costs of work. In reality, though, the work was still done under their supervision and not independently. Therefore, these were all cases of bogus self-employment. However, the work of people who are bogusly self-employed is very difficult to examine, as the work of people who are registered self-employed is legal until supervisory bodies find that it is being performed under supervision.

Another problem connected with self-employment, particularly in case of services installation, finishing, and renovation works, is failure to declare part of these activities to proper tax and insurance authorities. This undeclared self-employed work, according to employers' organisations, can encompass a majority of activity marketing these market sectors.

### Dynamics

In the period 1999-2003 the contribution of undeclared workers to generating the volume of the construction-assembly production increased significantly. According to the social partners it is around 30% and the percentage of undeclared workers in the construction labour market can extend to 40% of the market. According to official statistical data there is an average of around 588,000 employees in the construction sector; therefore, the number who are undeclared would be more than 230,000, which is a huge group of workers. According to some reports, the number of undeclared workers in the construction industry is even higher – over 500,000. It is worth remembering that repairs that often include construction work are classified in a different PKD group (Polish Classification of Activity), Retail and Repairs. These estimates also provide only an average number of workers, and there is a high turnover on the undeclared labour market (both in groups of local and foreign workers).

Social and economic partners, referring to the dynamics of the undeclared labour market in the construction sector, do not see Poland's membership of the EU as significantly influencing (either an increase or decrease) the share of undeclared labour in the labour market in the sector. This situation could change in the face of a deficit of a qualified labour force. Seasonal, or for a longer period of time, departures of qualified construction workers, mainly to Great Britain, Ireland, Germany, Italy and Belgium, creates a gap which can not be filled immediately by the national educational market and neither, as it turns out, by importing qualified workers from neighbouring countries. In this context it is possible to predict that small employers will exert a pressure to ensure that the process to legalise qualified foreign workers becomes easier. At the same time, owners of larger companies will press for foreign subcontractor enterprises from third countries (mainly Ukraine) to be admitted into the market (something they are already pushing for). Simultaneously, the interest of employers in the support of professional training and education process will rise significantly.

### Effects

Unregistered employment is an element providing competitive advantage to businessmen acting in the shadow economy, or on its fringes. It is made possible because of the weakness of the system of public procurement, an absence of suitable legal forms of employment for construction work in services installation and repair and maintenance, the weakness of supervisory systems and the difficulty of enforcing controls which are connected to the peculiarities of the construction sector. Companies employing unregistered workers have lower labour costs and are able to complete a task for a cheaper price.



Evaluation of government tax losses caused by undeclared activity and employment of unregistered workers is difficult because of considerable differences in opinion about the proportion of GDP that is generated by this sector of activity, and also about the structure of the shadow economy. It is similar in the case of construction. The durability and stability of the majority of construction companies, all rather small or very small undertakings, is weak.

The high share of non-salaried components in the costs of labour (about 50%), and a considerable share of insurance components in these costs, means that a significant number of unregistered workers are not contributing to financing the system of social security. This seriously threatens the functioning of this system. There is no separate system of social security in the construction sector, so it is not possible to talk about its erosion. But a large number of unemployed people still receive unemployment benefits and illegally take up jobs in the construction sector and this contributes to a weakening of the system.

## Measures

Broadening the sphere of legal employment is not one of the priorities of the state's employment policy. Among many programmes and planned activities of the state there are some that favour declared employment (such as First Work and First Business). The legal basis for activities limiting undeclared employment and the shadow economy is the Act which seeks to promote employment and the institutions of the labour market. It indicates clearly a different role for the institutions of the labour market than the management of unemployment and payment of benefits. However, similarly to previous years state policy on employment is oriented more towards facilitating the legalisation of employment rather than counteracting undeclared employment. It should be done through a reduction of employers' tax obligations connected with labour, a reduction of obligations for the system of social security, and introducing and implementing elastic forms of employment. There is an assumption, however, that the limited activity of social partners on this issue, combined with the limited influence of employers' organisations and the marginal significance of collective regulations, will mean that this policy of liberalisation may lead to a relative decrease in the existing standards of labour. This would result in longer working hours, lower social and security benefits and limited growth of salaries.

## Good practices

The Act of 27th June 2003 which allowed for the creation of Provincial Treasury Committees is an example of coordination of activities directed against illegal employment. In the Ministry of Finance 2006 recommendations, the control of the legality of employment ranks highly among the priorities of the activities of the treasury control services. It is essential that migration policy in the area of employment is incorporated into government documents (for example, The National

Plan of Activities for Employment). Unfortunately, it is hard to find a direct example of good practices by public institutions relating to the promotion of registered labour in construction.

With only limited interest by public institutions (except the control institutions) towards problems of undeclared labour in the construction sector, initiatives by social partners take on special significance. The main partner organisations – such as the Confederation of Construction Industry and Real Estates, the Polish Union of Construction Employers, The Union of Polish Handicraft, The Trade Union Budowlani, and the Building and Wood Industry Secretariat of Solidarity – clearly underline in their activities the priority of taking actions to counter the shadow economy in the construction sector and to reduce undeclared labour. An example of such an activity is the agreement, signed by two employers' organisations and two trade unions, on the minimal hourly estimation rate in construction for the next three years, and activities to incorporate some checks into the laws relating to public procurement to eliminate the chances of them accepting bids which include cheap labour. In March 2006 the Tripartite Team of the Construction Sector began its activities (employers' organisations, employees and representatives of key government departments for the construction labour market). The focus of this team's work will be to limit the shadow economy. Social partners are currently considering entering into negotiations for a sector collective arrangement in which regulations limiting unregistered labour would be included.

# Spain<sup>16</sup>

## Regulation and institutions

From a legislative point of view, there are two areas which govern and control undeclared labour and the shadow economy: labour authorities and tax authorities. This paragraph will then discuss the field of collective negotiations, followed by legislation on bidding and contracts in public works. These two latter areas are of little relevance in the prevention and control of undeclared labour in Spain.

### Legislative aspects

Since the 1990s, new 'atypical' forms of employment have been developed in employment laws with the aim of creating more jobs and also partly to promote the transformation of undeclared labour into declared labour. However, there is no evidence that this has actually occurred in the economy in general or in the construction sector in particular. Furthermore, since 1997 permanent contracts have been promoted as well as cost reductions in dismissals.

Laws on subcontracting are of particular interest in the construction sector. The workers' statute (the fundamental law on labour rights) permits productive decentralisation, providing it respects the guarantees that are provided to prevent violations of workers' rights. The statute states that the principal company that enters into contracts and subcontracts for labour or services that form part of its own activities shall be jointly liable for any non-payment of wages and social security

<sup>16</sup> The basic country report was written by Oscar Vargas, Javier Gonzalez and Francisco Jose Rodriguez, Labour Foundation for Construction, Spain. The complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

contributions, and shall have subsidiary liability in social security obligations and responsibilities in the event of insolvency.

The Labour and Social Security Inspectorate (within the Ministry of Labour and Social Affairs) is responsible for controlling all forms of undeclared labour, particularly in relation to irregular employment and social security fraud, and to monitor all other labour regulations, including collective agreements. Therefore, it is responsible for controlling the most typical forms of undeclared labour. The sanctioning regime implements economic fines for the employer and worker alike, and also employs another series of measures for illegal foreigners (return to border, deportation and expulsion from Spain). It is also responsible for ensuring companies' compliance with labour regulations under the regime for free provision of transnational services. It takes ongoing action against irregular employment with regard to foreigners and Spaniards alike, identifying enterprises that do not appear in the social security system, non-registered workers and those who unduly receive social benefits. In 2003 the Labour and Social Security Inspectorate launched a special action on non-compliance with the obligation to register employees in the social security system in sectors that have the highest incidence of fraud. At this time, the construction sector was not included in this. However, the 2005 control plan focused on construction, agriculture and textiles. The inspection authorities acknowledge that there is a significant amount of casual work in the construction sector, although there is no specific plan for the sector for 2006.

The Tax Office (Ministry of Economy and Finance) controls tax fraud and is in charge of ensuring that the national fiscal system is applied effectively. Among its control instruments is the Fraud Prevention Plan. This plan contains a specific section on the construction sector. The plan states that the principal risk is hidden income and this can occur on major building sites and also in minor renovation work on premises and houses.

### Collective agreements

There is a collective agreement in force for the period 2002-2006 that applies to all enterprises and workers in the sector. The agreement governs wages, hiring and dismissal, total working hours, holidays, maximum overtime, health and safety and so on. To date, undeclared labour has not been the subject of collective negotiations or an issue of general concern on the part of the social partners. However, there are several aspects, such as subcontracting, types of contract and working hours that have an indirect influence on undeclared labour, and these aspects do indeed form the subject of collective negotiations. In any event, the clauses in the agreement that discuss these issues are focused more on labour risk prevention and preventing insecure employment.

### Public contract aspects

Royal Legislative Decree 2/2000 that approves the Contracts Law states that one of the criteria for demonstrating technical solvency is the declaration of the company's

mean annual workforce, stating, where appropriate, the degree of employment stability among personnel. The same applies here as in the collective agreement; it is focused more on controlling insecure employment rather than reducing undeclared labour.

## Nature and features of undeclared labour

### Definition

The most commonly used term for undeclared labour in Spain is ‘irregular’ labour. In this respect, Luís Toharia defines an irregular worker as a worker who is declared as employed but holds an irregular situation with the social security system. The worker’s situation in the social security system is a key factor in defining whether they are participating in undeclared labour. The labour is declared if he/she contributes to the social security system and if such labour corresponds to the appropriate labour regime (as an employee, self-employed person and so on).

More recently, Enrich Sanchis discussed unpaid labour and shadow labour. He considered the definition of undeclared labour in Spain, and distinguished between:

- all activities that are defined as illegal by virtue of their very nature, forming part of the criminal economy;
- conventional productive activities that are carried out in infringement of fiscal and labour laws.

The second definition matches more closely the definition given in the European Commission’s Communication for Undeclared Labour, which is “any paid activities that are lawful as regards their nature but not declared to the public authorities”.

Therefore, in this chapter, undeclared labour shall be understood as any paid activities that are lawful as regards their nature but not declared to the public authorities either in full or part. It should be remembered that regular workers who also do moonlighting undertake the majority of undeclared labour in Spain.

### Different forms

When the above definition is applied to the construction sector, the following different forms of labour can be classified: foreign workers without work permits, regular job holders who moonlight, workers who receive social benefits without having a right to them, work undertaken on a small scale by individual workers, teams with intermediaries, subcontract chains (the last link in the chain) and also, possibly, workers subject to free provision of services abroad.

### Extent

In 1986, a study undertaken by the Ministry of Economy and Finance (FLC) estimated that there was a 20% rate of hidden employment in the construction sector, which was close to the national figure (21.9%). Continuing the estimate of undeclared labour, the FLC made a study of employment data from the Active Population Poll

(EPA) and data on Social Security Registration (SSR). The first source reflects the number of employed persons in the construction sector using a polling method while the second is a workers' register, regardless of their professional situation, and therefore is a better reflection of declared labour. For several reasons, including situations where someone undertakes a formal job alongside an informal one, it is only possible to make an estimate. It should also be noted that, according to the Ministry of Economy and Finance calculations, 66% of irregular labour is accounted for by employed workers who do not pay into the social security system in the national economy as a whole.

Using this procedure to estimate undeclared labour, approximately 11% of workers in 2004 and 7% in 2005 carried out undeclared (not registered) labour in construction. Therefore, taking into account the fact that this phenomenon also occurs among registered workers, the figure will be somewhat higher, possibly 20% as in the Ministry of Economy's report.

This method of estimating undeclared labour is a valid index for comparing certain groups in the construction sector. For example, the analysis performed by the FLC using the same procedure shows that immigrants represent the highest percentage of non-registered workers, followed by self-employed persons, who in turn are a higher percentage of non-registered workers than employees.

## Functioning of the undeclared labour market

### Actors

According to the interviewees who were part of this research, undeclared labour in the Spanish construction sector is principally related to:

- individual workers who carry out renovation work, repairs and maintenance in private homes in an informal and/or formal context;
- foreign workers without work permits principally on small and medium-sized building sites.

These two parameters are the most significant forms of undeclared labour. Irregular labour is also found in pyramids of subcontracting; typically at the end of the chain.

Illegal foreign workers form the most vulnerable groups and are attracted by the existence of jobs that have been refused by the local population. Immigrant workers account for about 20% of this sector and, according to estimates, a third of these workers are not registered with the social security system. They suffer worse working conditions than other workers. These conditions and the illegal status of some immigrants make them inclined to take on undeclared labour.

A second group is made up of self-employed workers who have multiple jobs. Their principal employment forms part of the official economy, and at the same time they undertake undeclared labour (especially in repairs, renovation work and so on). Furthermore, in the construction sector there is quite a significant group of self-employed workers who pay social security contributions under the employees' regime and, vice versa, employees who pay contributions under the self-employment regime.

These are workers who are bogusly self-employed. According to the labour inspectorate the number of bogus self-employed (including site managers and building workers) has risen recently. This is because of a general decentralisation of production and organisation of work in the whole economy.

Totally undeclared labour is found among so-called 'handymen' who normally have low skills levels. This group of individual workers are not registered with the social security system and therefore do not declare anything.

Some workers' units that depend on an intermediary are also in an irregular situation, as mentioned earlier. They almost always get jobs through an intermediary (an illegal agency or self-employed person). They tend to be vulnerable workers.

Another group of workers can be classified as those who receive unemployment benefit at the same time as undertaking undeclared labour. This social benefit fraud is much more common in construction and agriculture than in other sectors because of the seasonal nature of this work. Almost one in five of irregular workers in the construction sector fall into this category.

Finally, there is the group of employees who work for small and medium-sized enterprises, forming part of long subcontracting chains. They are involved in a variety of irregular practices such as undeclared hours and cash payments. The incidence of hidden labour is less relevant than in other groups. From the employers' view, subcontracting is not the cause but reflects the bad use of this form of labour organisation. According to the labour inspectorate, large chains of subcontracting can tend to create situations of undeclared labour in the last parts of the chain, as the benefit margin is much reduced and the only way to survive as a worker or small company is to work undeclared.

## Segments

A report written by CC.OO. (Comisiones Obreras Trade Union Confederation) on the shadow economy indicates that, according to investigations conducted in the 1980s and 1990s, the shadow economy was present in sectors with reduced capital intensity, individual employment in basic technologies and according to its possibility of decentralising production. Other authors highlight that irregular labour is found more frequently in the following scenarios: among labourers with only basic skills, many small companies, where there are low rates of trade union membership and where personal channels are used for securing labour contracts.

If we use the typology of undeclared construction labour included in the CLR-document 'Undeclared labour in construction: preparatory research, January 2006', then undeclared labour in Spain would be principally represented in the *marginal informal* category, and in general it would have the principal main characteristics of the scheme of the aforementioned document, with some differences of note with regard to skill level. In Spain there is a greater emphasis on illegal labour provided by local, unskilled workers that are not registered, and informal undeclared labour undertaken as moonlighting in addition to declared labour (in the latter case workers are usually skilled workers). Handymen would be included in this category (individual workers in an informal context).

The next most significant category would be *unofficial enterprises*, and the characteristic form would be workers' units that are not registered within the social security system, with a low level of organisation but with some degree of specialisation. Most illegal immigrant labour belongs to this group. Another characteristic of this group is that there is an intermediary that 'illegally' supplies the workers, and this intermediary may take the form of an illegal agency or a self-employed person. In Spain temporary employment agencies are prohibited in the majority of construction labour (as it is considered a high risk sector).

In general, the *official enterprises'* category described in the scheme matches the Spanish situation. Undeclared labour is particularly present in small and medium-sized enterprises, because large enterprises have developed administrative mechanisms to control subcontractors and the workers that they use. This control is carried out by keeping a register and by visibly labelling the workers, for example, on their helmets. However, despite this control, irregular forms of labour can occur (in the grey area of reduced control). In the large enterprises there is a stronger trade union presence, which helps to maintain very low levels of irregularity. It should be added that in the official enterprises' group there is a significant presence of undeclared labour through paid overtime that is not declared. In large enterprises, the incidence of undeclared labour is probably limited to hiding a certain amount of undeclared overtime. The more common undeclared labour in small and medium-sized enterprises is mainly seen in the form of undeclared overtime, undeclared parts of wages, absence of contracts, especially in more temporary and less skilled labour, and particularly significant among legal and sometimes illegal immigrant workers.

In subcontracting, undeclared labour also occurs as a result of the *free provision of services in Europe*. This is mainly the case of enterprises that come from Portugal, that are subject to the labour terms laid down in the General Agreement for Construction in Spain. Since these workers are employed by a Portuguese enterprise, in many cases the terms of the agreement are not fulfilled. This is a form of undeclared labour in the sense that it is believed that some of these enterprises do not comply with sector regulations.

From a geographical point of view, undeclared labour is proportionally more widespread on small sites in rural areas, in the residential outskirts of large cities and in Mediterranean coastal regions. The reasons that undeclared labour is found in these zones lie in cultural values and economic structure, since in many regions along the coast construction plays a major part in the economy at a direct and indirect level.

## Reasons

A report written by the Economic and Social Council (CES), regarding the Toledo Agreement, points out that there may be a marked relation between irregular or hidden activities and formal activities. It is therefore easier to understand why the majority of undeclared labour occurs in activities that are not completely hidden.

In 1997, José Manuel Molina, ex-president of the Senate's Labour and Social Security Commission, decided to organise a study from a social point of view, in order to delve deeper into this problem. The experts who wrote the study described



Spaniards' attitudes to the shadow economy. In general, the study concluded that part of the population is quite tolerant towards undeclared labour. It was found that the principal reason for working without a contract or social security was that persons could not find another type of work to substitute the undeclared. This indicates that the most vulnerable groups of workers undertook a large part of undeclared labour at that time.

Other reasons for doing undeclared labour came much further down the list: greater flexibility with regard to hours, compatibility with other activities, paying less tax, or taking advantage of receiving unemployment benefit at the same time as working. Employers tend to use irregular labour to save paying social security and taxes. Others mention that it is easy to dismiss illegal workers, and that irregular labour is simply a way of avoiding restrictions imposed by contractual laws.

### Dynamics

Although no sources solely base their investigations on undeclared labour in the Spanish construction sector, official statistics show that certain variables related to a higher incidence of this phenomenon are characteristic for the construction sector:

- subcontracting has grown significantly since the 1990s;
- companies are small and trade unions have a weak influence in these companies;
- productive activity is of a seasonal nature;
- vulnerable workers are employed, particularly in irregular job creation through immigrant workers' contracts.

Other factors that might have stimulated the growth of undeclared labour in the construction industry are the growth of activity and employment during the last six years. Besides, the low qualification of some new small entrepreneurs and their lack of knowledge about the law and rules to set up a new company could lead to undeclared practices in some trades.

### Effects

The main causes of undeclared labour found were: saving costs, social values (low awareness level), characteristics of the industry (complexity, abuse of subcontracting, temporary activity, and migrant workers as a vulnerable group).

Reduction of productivity costs affects competition among companies. This is much more serious in the case of individual workers who are not registered with the social security system and therefore hardly declare anything. Furthermore, since they are less controlled, there is greater non-compliance with collective agreements; this in turn affects health and safety, and building quality. This leads to negative effects for the image of the sector, which is one of the biggest problems in attracting new workers.

There is not a very high incidence of undeclared labour in terms of productive monetary value, since the largest part of economic production comes from the large and medium-sized buildings sites where there is proportionally less fraud derived from the hidden economy. In this respect, certain taxes related to productive value are not

particularly jeopardised. However, social security fraud does have negative effects on the economy in general (services and social provisions), and also on the collective actions on the part of the FLC, due to reduced income from fees. This situation affects solidarity mechanisms and actions developed by the Foundation related to vocational training, health and safety, and improvement in employment conditions.

There are two different opinions on the incidence of undeclared labour on workers' health and safety. The first opinion (according to a key informant from the labour inspectorate) is that it is more difficult to enforce safety regulations in the shadow economy and therefore there are greater risks derived from probably worse working conditions. These more precarious conditions are equally likely to occur on small sites (where the risk is supposedly smaller than on large sites), because even in house building or renovation there are health and safety risks for workers (for example, work at height).

However, one trade union informant mentioned that the adverse effects on health and safety are probably not so great in terms of severity of accidents, since employers do not want to take big risks, and therefore, when high risk activities have to be carried out the employer registers his workers with the social security system. This phenomenon is applicable to enterprises (groups of workers) but not to individual workers who are not registered with the social security system, or to self-employed persons who provide declared alongside informal labour.

The general opinion is that workers who undertake undeclared labour have lower skills for two reasons: first, irregular workers have no rights to attend continuous training programmes; and second, individual non-registered workers are characterised by a low level of skills because they are not required to provide professional certification and base their competitive value on reduction of production costs rather than on quality. This is not the case for self-employed workers who carry out declared and undeclared labour.

## Measures

At present a law is being debated in Congress that will further govern subcontracting. The objectives sought by this bill are to reduce temporary contracts and accidents, and promote compliance with all types of regulations. It is expected that there will be a reduction in undeclared labour as a result of limiting the amount of subcontracting and increasing the control of the same.

Organic law 14/2003, regarding the rights and liberties of foreigners and their social integration, covers the legalisation of non-EU workers. The law is developed by Royal Decree 2393/2004 that lays down the control and preventive mechanisms regarding undeclared labour, including the requirement of holding a work visa and residence permit before a foreigner can start to work. One new point in this law is that there is now a visa to enable a foreigner to seek work by permitting free movement in Spain for a period of three months, in order to find a job. During this time, the foreigner may even register at public job centres.

Extraordinary legalisation processes are also worth mentioning here. The 2005

process provided two paths towards legalisation: length of stay (for foreigners who had been in Spain for a consecutive period of at least three years), and length of employment (for foreigners who had worked in Spain for at least two years consecutively).

In relation to EU workers, Law 45/199 should be mentioned, whereby EU workers may travel in order to provide transnational services. The basic principle established by this law is that within this scope of application, employers who move workers temporarily to Spain must guarantee to comply with certain working conditions for these workers, as provided in Spanish legislation: working hours, minimum wage, non-discrimination between temporary and part-time workers, health and safety at work and so on. These conditions are governed by the collective agreement for construction.

The competent authority that grants the administrative authorisation to issue foreigners' work permits is the Provincial Delegation of Labour and Social Affairs (the Ministry). It is responsible for granting or rejecting work permit applications.

In the 1990s specific instructions were issued to inspectors working in the construction sector to identify fraud in social security and unemployment benefits, and in labour relations established under the guise of a hire or works contract (bogus self-employed persons). Furthermore collaboration has been established between the Labour and Social Security Inspectorate and the State Employment Public Service, by means of a Collaboration Agreement on employment and unemployment benefits for the year 2004 thereafter in order to control payment of unemployment benefits to undeclared labourers.

Incentives for entering into permanent contracts with disfavoured population groups (women, young persons and persons over the age of 45) as well form part of the fight against undeclared labour.

Information and awareness campaigns were also launched during this period, in collaboration with social actors in order to increase social awareness of this problem.

## Measures in fiscal-related aspects

First, the income tax reform implies a reduction in the range of income tax rates on labour, particularly for workers with a low income. A new fiscal law came into force in 2004, and one of its principal objectives was to strengthen the Tax Office's means of fighting against fraud and tax evasion, by means of new regulations on legal fraud, infringements, and fiscal sanctioning.

Specific fiscal measures in the construction sector include:

- *monitoring of building works* from the very start, with prior information collection, planning of intensive and coordinated actions, particularly among large enterprises;
- obtaining information from councils and professional associations, at least on major repair and building works, with regard to *building permits awarded*, which will contain details of the works to be undertaken and budgets for the same;
- verification of invoices in the event of suspected *risk of false invoices*, or stating larger considerations than the actual consideration;

- studies and reports to facilitate the application of indirect estimation in the case of *subcontractors* that do not keep books or present such documents.

Coordinated action plans are regularly launched by the Ministry of Economy and Finance together with the Ministry of Labour and Social Affairs, in order to identify and control cases of shadow economy.

## Good practices

### Awareness campaigns

An awareness campaign in Murcia on irregular labour in general. In 2004 the Board of Labour and Social Policy for the Murcia Region launched an advertising campaign to encourage workers and employers to declare economic and labour activities, called 'Say no to the shadow economy'. The message was based on the economic and social benefits reaped by companies that declare their activities. According to the results of the public opinion poll carried out by CIS (Sociological Research Centre), this type of campaign gives results in preventing undeclared labour.

### Good practices in construction enterprises

Some companies train workers in their country of origin and then the workers come to Spain to work legally, with a labour contract that has already been signed. This solves two problems: a legal employment, and optimum workers' skills (for example, a Galician enterprise in Morocco).

Within the panorama of increased subcontracting, large construction enterprises develop administrative mechanisms in order to differentiate regular and irregular workers on large building sites. These mechanisms consist of a series of conditions that each employee and company have to fulfil, by presenting certain documents such as labour contracts, invoices and so on. Workers who have fulfilled these conditions then have to wear a card or sticker on their helmet. The contractor then carries out visual inspections and any workers who are not duly identified are sent off the building site. This prevents workers from exchanging jobs without control (depending on their ethnic origin), and all other types of undeclared labour.

### Legalisation of immigrant workers employed by Spanish companies

In the construction sector, immigrant workers account for 20% of the entire workforce. Furthermore, on 30th September 2005, 26.74% of all foreign workers registered with social security belonged to the construction sector, representing 306,926 immigrants out of a total of 1,147,719 registered under the General Regime. In short, construction is the economic sector with the highest percentage of foreigners.

The extraordinary legalisation process of 2005 involved foreign workers who were already in Spain six months before the process came into force. They were eligible if they had a definite employment offer for a term of at least six months, and if they

fulfilled certain requirements. The peculiar characteristic of this process was that workers had to demonstrate that they were in a labour relation, even if the employer had been reported. Employers were also told that they could register their workers without being sanctioned for having irregular workers.

This legalisation resulted in the introduction of new workers in the formal economy. In this respect, the Ministry of Labour and Social Affairs reported that “in 2005, the legalisation of immigrant workers has led to considerable surfacing of shadow economy; over 550,000 non-Spanish citizens have been registered with the Social Security, which is not only beneficial for them since they are now working legally, with all their corresponding rights and obligations, but it is also positive for many companies that have found an ideal way of legalising the irregular situation of some of their employees. The legalisation process has given rights to the majority of immigrants who have worked illegally up until now.” Some sources, such as CC.OO. trade union, quoted by the above newspaper on 6th August 2005, said that 22% of migrant workers were legalised. If we assume the same percentage for the construction sector, 154,000 migrant workers were legalised. This figure is probably somewhat lower, but it is clear that these data reflect the efficacy of the measure for the immigrant collective, and also the great magnitude of undeclared immigrant labour in the construction sector among migrant workers in 2005. In fact, in 2005 the estimated percentage of workers not registered with the social security is about 7%, in comparison with a figure of 11% in 2004. It is highly likely that the immigrant legalisation process has brought about this change.

### Planned project

The new law on subcontracting in the construction industry limits the number of subcontractors to three (‘in a chain’) and is agreed between political parties, unions and employer’s organisations. Four points deserve to stand out:

- a third subcontractor will not be able to put in charge to a fourth one the task that has been entrusted to him;
- moreover, subcontractors will not be able to subcontract those activities, which basically involve manual labour work with no specialisation;
- the obligation to set up a ‘subcontracting book’ has been established in order to register subcontracting chains, deadlines and health and safety plans;
- finally, the workers’ representatives of the different companies taking part in the construction site must be informed about the contracts and subcontracts taking place in the site.

This new law will enter into force next year (2007). It is expected that the number of long subcontracting chains will diminish and there will be more control over bad practices (such as undeclared labour) on sites.

# United Kingdom<sup>17</sup>

## Regulation and Institutions

### Taxation and Social Security

In the UK, the Inland Revenue (IR) is responsible for administering taxes, such as income tax, capital gains tax and corporation tax, and, since 1999, National Insurance contributions. It is the employer's responsibility to deduct tax and National Insurance contributions at source from the employee's pay under the Pay As You Earn scheme (PAYE) and to pay it directly to the Inland Revenue. Most employees pay tax under this system. The operation of PAYE is based on the Income Tax (Pay As You Earn) Regulations 2003 and the paying of National Insurance contributions is based on the Social Security Contributions and Benefits Act 1992, Social Security Administration Act 1992, Social Security (Contributions) Regulations 2001, as amended, and Social Security (Categorisation of Earners) Regulations 1978, as amended.

Other authorities responsible for taxation and social security are HM Customs and Excise, the Department responsible for the collection of VAT and excise duties, and the Department of Social Security (DSS), responsible for policy on social security benefits and for the executive agencies that carry it out (chiefly the Benefits Agency).

### Labour legislation

Since 1997 the UK Government has introduced a programme of legislation establishing, for the first time, a comprehensive framework of minimum employment standards. The legislation covers: working time, the National Minimum Wage; trade

<sup>17</sup> The basic country report was written by Maria Gribling, Linda Clarke, Westminster Business School, London, UK. A complete report is available on [www.clr-news.org](http://www.clr-news.org) under publications (CLR-Reports).

union recognition and membership; unfair dismissal and workplace procedures; and equality/discrimination provisions, etc. The Employment Tribunal System provides the usual enforcement route for individual rights.

The Health and Safety at Work Act 1974 provides the legislative framework to promote high standards of health and safety at work. Health and safety law is enforced by inspectors from the Health and Safety Executive (HSE) or by inspectors from the local authority, who have a wide variety of statutory powers. Breaches of health and safety law can result in substantial fines and even imprisonment.

There is no labour inspectorate in the UK. Inland Revenue, the Department of Work and Pensions, the Health and Safety Executive, and the Home Office are responsible for controlling different aspects of work and employment according to their area of intervention.

### Licences and other building regulations

The Construction Skills Certification Scheme (CSCS) is related to skills recognition and is currently growing in importance throughout the industry. It was introduced in April 1995 to provide a means of certifying that construction workers' skills have been validated against national standards and that they have the required knowledge to operate safely on site. It was started to help the construction industry improve quality, reduce accidents, and to drive 'cowboy builders' out. Applicants to the scheme are required to demonstrate competence (the ability to carry out their job well) and knowledge of health and safety (Construction Industry Council website).

By 31 January 2006, CSCS had 829,387 cardholders or affiliated cardholders, in 230 occupations (CSCS website). The scheme is managed by CSCS Limited whose board members come from the industry: Construction Confederation (CC), Federation of Master Builders (FMB), GMB Union, National Specialist Contractors Council, TGWU (Transport and General Workers Union) Building Crafts Section, UCATT (Union of Construction, Allied Trades and Technicians), CITB-ConstructionSkills, Construction Industry Council and the Construction Clients Group.

### Labour organisations and sectoral institutions

The trade unions represent a declining proportion of employees, with trade union density estimated at 17 %, having fallen from 26 % in 1995. There are four main unions with members in construction: UCATT with an estimated membership of 110,000, many employed in local authorities; TGWU; GMB, with about 20,000, many in building materials companies; and AMICUS which represents some of the more skilled workers including – traditionally – electricians and plumbers. There is no longer any clear difference between these as to which occupations each recruits and they therefore compete with each other for membership and have little formal cooperation.

The employers on their part are represented through the Construction Confederation (CC), which acts as an umbrella body ensuring that government, the media and other opinion-formers hear the voice of the industry. The CC comprises

six member federations: the British Woodworking Federation (BWF), the Civil Engineering Contractors' Association (CECA), the Major Contractors' Group (MCG), National Contractors' Federation (NCF), the National Federation of Builders (NFB) and Scottish Building. These in turn have more than 5,000 member companies, accounting for over 75% of industry turnover. In addition to the CC, there is also the FMB, representing many of the small builders. Just as with the unions, which represent only a small part of the workforce, so the employers associations too tend to represent the larger rather than the myriad of small companies in the industry.

As well as the employers' organisations and trade unions, there are two other main bodies which exist at industry level: CITB-ConstructionSkills and the Building and Civil Engineering Benefits Scheme. In terms of vocational education, the Construction Industry Training Board (CITB), one of the two remaining statutory industry training organisations, is dominated by private business interests with contractors having the majority, there being only two trade union members. It is funded through an industry levy of 0.5% of the payroll of main contractors and 1.5% of labour-only subcontractors. As well as being the new Sector Skills Council, the CITB operates as the lead body for setting occupational standards, the National Vocational Qualifications (NVQs) awarding body for the industry, accreditor of assessors, manager and policy developer for industry training and manager of CSCS.

The other industry bodies are the Building and Civil Engineering Benefit Scheme, and the Plumbing and Mechanical Engineering, Electrical Contracting, and Heating and Ventilating Engineering Joint Industry Board Schemes. They offer different benefits, which can be regarded as compensating for the frequently casual, irregular, seasonal and mobile employment in an industry consisting of many small employers (Clarke 1998). The largest of these, the Building and Civil Engineering Benefit Scheme (B&CE), includes holiday pay, sickness, disability, lump-sum retirement and death benefits. It is jointly run by the CC and the trade unions – UCATT, TGWU and GMB.

## Nature and features

### Definition

Undeclared labour arises from non-compliance with legal and conventional regulations in the field of taxation and fiscal law (both income taxes and VAT), social security, labour law, collective and sectoral agreements.

Self-employment is a questionable status open to cash-in-hand, with no clear control, a very blurred line between formality and informality, and tremendous tax fiddling/ tax avoidance. Research carried out by the Small Business Council concludes that the vast majority of informal work is carried out on a self-employed basis, with three kinds identifiable:

- micro-entrepreneurs who use the informal economy as a short-term risk-minimising strategy to test-out their enterprise and/or establish themselves;
- the informal work of more established small companies and self-employed people who use this sphere in an ongoing and serial manner as a strategy for 'getting by';



- and the informal work of ‘favour providers’ who conduct mostly casual one-off small tasks as ‘paid favours’ for friends, family and acquaintances.

## Different forms

The British construction industry relies heavily on subcontracting, which has a significant impact on the employment relationship. Since the 1980s, employing organizations in the UK have shifted employment practices in ways that have increased the numbers of people in the ‘contingent’ workforce. Currently main contractors manage the projects and the finances, but usually do not employ labour; subcontractors, gang masters and agencies employ or supply labour. The large numbers of subcontract arrangements enable companies or individuals to set up companies and use agency labour almost at will, with as a consequence serious ambiguities in the employment relationship.

With compulsory competitive tendering in the public sector being given a legislative basis by the Local Government Acts of 1988 and 1992, subcontracting in Britain is so all-pervasive that it extends to subcontracting only for labour (labour-only subcontracting), with even those working for subcontractors having contracts for services as self-employed workers rather than contracts of employment. Labour-only subcontractors (LOSCs) trade essentially on the difference between the price they pay labour and the price they sell labour, thus contributing to the labour cost pressure.

Although subcontracting allows for labour flexibility and swift response to fluctuating market demands, it passes risk down through the sub-contracting chains, thus making it increasingly difficult to assign responsibility in a long chain of employers. As a result, a grey area is created, where the formal and informal economies and networks coexist, and where even large registered companies are likely to rely sometimes on subcontractors from the informal economy. A lot of undeclared work is likely to be going on because of the extent of subcontracting.

Self-employment under its widespread form in construction is regarded by all of our respondents and in the literature as a major problem with serious socio-economic consequences. The economic incentives created by the taxation classification of self-employment status are considered throughout the industry as responsible for mass occurrence of false and illegal self-employment. According to the OECD (2000), “in some countries [...] taxation systems, and perhaps labour market policies as well, might have encouraged the development of ‘false’ self-employment – people whose conditions of employment are similar to those of employees, who have no employees themselves, and who declare themselves (or are declared) as self-employed simply to reduce tax liabilities, or employers’ responsibilities.” In the UK, the taxation regime has created a climate of extreme cost-driven competition and erosion of the employment relationship.

The legal recognition of only two categories of employment status, the employed (with contract of services) and the self-employed (with contract for services), creates the risk of confusing temporary, casual and fixed-term employment with self-employment status. An additional complication is the category of ‘worker’, which includes ‘the dependent self-employed’. In line with this, the FMB respondent

emphasised that the question of who is self-employed and who is directly employed is ambiguous, especially in construction where site particularities can create a master-servant relationship usually associated with direct employment (e.g. working time, signing-in and out, lunch breaks); and that in fact, nobody knows what a self-employed person is, as it is decided on a case-by-case basis. Quite often, people are notionally self-employed with long-standing engagements with the same contractor or employer but are flexible because of their status. Inland Revenue also recognises that there are special difficulties in the construction industry because labour-only subcontractors are often short-term or casual workers, and there is often confusion about whether holding a subcontractor's tax certificate or registration card means that a worker is self-employed.

### Extent

Data about the black economy are understandably scarce and often based on small sample surveys or on estimates. The figures below are therefore not reliable. However, they do give an idea of the volume of undeclared work that is believed to exist next to work in the formal economy.

The number of self-employed persons in construction in the UK increased from 625,000 to 692,000 between the first and the last quarter of 2004, while total manpower increased from 1,659,000 to 1,754,000 over the same period. A large and increasing proportion of the construction workforce is self-employed, estimated at 60% of skilled workers by our UCATT respondent.

According to the Small Business Council, about half of the UK informal economy is located in the construction sector, particularly the home improvement and maintenance sphere. The results provided by the Rockwool Foundation Research Unit in 2003 reveal that 46.7% of undeclared work among 18-74 year olds in Great Britain is attributable to construction. Of this, 17.2% is found in painting and decorating, 11.1% in carpentry and joinery, 1.3% in bricklaying, and 17.2% in other trades, such as electrical and plumbing work. The survey is, however, based on a small sample.

The English Localities Survey identifies similar results in relation to the domestic services sector. Examining eleven affluent and deprived urban and rural areas, 43% of all informal work was found to be concentrated in the home repair and maintenance/construction sector. The tasks identified as most frequently using informal rather than formal labour were: attic conversions (one in four are done informally); installing a bathroom (24%); plumbing (13%); electrical work (12%); plastering (12%).

According to the FMB, the informal economy in the domestic repair, maintenance and improvement (RMI) sector accounts for one-third of all work carried out; however, its true size is difficult to estimate because of the highly fragmented nature of this type of work, as well as the numerous micro, small and medium-sized building companies that form the sector.

Department of Trade and Industry estimates contrasting household spending on RMI work with official RMI output data put informal economic activity at around £7bn in 2002. The Informal Economy Working Group, a joint Government and industry project, further estimated that some 80% of informal economic activity in

the private domestic RMI sector was by illegally unregistered companies, with the remaining 20% being occasional 'cash-in-hand' work by registered companies.

In 2001, the CC estimated that 22% of building work in the UK was being carried out without the necessary VAT being charged by builders. This was all likely to have been done for the domestic market. It was suggested that "there are many thousands of building companies trading in the black economy". At their meeting in December 2000, representatives from HM Customs & Excise, the FMB and the CC agreed that broadly, 80% of informal economy work was likely to be attributable to unregistered traders and 20% to off-record work by VAT registered traders. FMB latest estimates put VAT evasion at about £7 – £12 billion.

## Functioning of the undeclared labour market

### Actors

The British construction industry continues to operate on a 'hire and fire' basis, whereby workers are only retained if required. It is very fragmented, characterized by extensive subcontracting, and a degree of informality in the engagement of labour. The market is cost-driven and dominated by extreme competitiveness. Employment and labour supply are shaped by employer demand with regard to market rather than social factors. In addition, insufficient coordination between different authorities, combined with weak control and enforcement of the existing regulations, allow for a variety of work arrangements such as 'bogus' self-employment, moonlighting, and informal, individual, and dubious practices at the bottom levels of pyramids of subcontracting.

Although subcontracting allows for labour flexibility and swift response to fluctuating market demands, it passes risk down through the sub-contracting chains thus making it increasingly difficult to assign responsibility in a long chain of employers. As a result, a grey area is created, where the formal and informal economies and networks coexist, and where even large registered companies are likely to sometimes rely on subcontractors from the informal economy. A lot of undeclared work is likely to be going on because of the extent of subcontracting.

The fragmented, casual and insecure character of the employment structure in the construction industry is a critical problem. In a de facto deregulated labour market, where the core labour market may be regulated to a degree but implementation of regulations is low, the occurrence of 'grey' or 'black' zone construction activities is only to be expected.

Several respondents pointed out that there is no clear-cut division between official and unofficial enterprises. It is unlikely, however, that official enterprises become involved in undeclared labour as, if they are registered, they are likely to be caught and face the risk of a 'short shelf life'. Providing cheap labour for official enterprises is not denied, but is mostly attributed to the need for competitiveness and lowest possible prices.

As for recruitment, informal networks dominate, such as word of mouth, ex-employees, workers presenting at the start of work at the gates and notification by

friends and acquaintances, or workers assembling at a well-known meeting point to be picked up by vans and sent to sites. In the case of migrant workers, migratory chains and personal and community networks can be important sources of employment. An embedded, structural feature of the UK construction sector is the reliance on relatively cheap sources of foreign labour.

Labour in construction is also provided by the employment agencies and LOSCs. These are governed by the Employment Agencies Act 1973 and the Conduct of Employment Agencies and Employment Business Regulations 2003. However, since 1995, anyone can set up and operate an employment agency without obtaining permission. A problem that often arises where workers are employed through a gang master or employment agency is that their employer is unclear.

According to a number of sources, document forgery is widespread and increasingly sophisticated. CIS cards are apparently available on the black market (building workers). Utility bills needed for proof of address and CIS cards can be forged and 'home-made'. Moreover, National Insurance numbers are easily obtainable and can then be used to for getting a tax number and a CIS card, thus giving workers in grey or black zone activities some kind of legality to use for getting a job. Often cards are not properly checked by employers either through ignorance, to avoid complications, or consciously if this would allow them to make savings and get away with it.

There is a hierarchy in the informal construction market in the sense that there is a differentiation in the type of work: migrant workers, even skilled, are often not hired for the most skilled work. Some groups are also more favoured than others, with those from black and ethnic minority groups especially discriminated against. Workers are however believed to be treated the same way when they are told on which project to work and where to go.

## Segments

Most of our respondents (e.g. CC, TGWU) argued that undeclared work was unlikely to occur on a large scale in official enterprises because of the fear of control and the problem of visibility. However, they still recognise the practice of "1-2 projects that may not go through the books" in the case of small traders, or the difficulties of control by contractors who often do not know who subcontractors are employing on sites (opinion of a building worker). Regarding the question of who engages in this work, it is not primarily 'marginal' populations, such as the unemployed or people living in deprived areas, but those already in employment. Moonlighting has also been linked to self-employed people being paid in cash and working at weekends.

Migrant workers were often cited by our respondents and in the literature in relation to undeclared work. Despite the widely recognised presence of migrants on building sites in the UK however, there is no data on undeclared work done by migrants. Migrant workers appear to be popular in the construction industry, as they constitute cheap labour working long hours in an industry with a labour shortage. It is possible to enter the UK on a visa as a self-employed person and subsequently find work in the sector; this contributes to the invisibility of migrants. According to our

interviewee from TGWU, construction is easy to get into illegally if there is already a migrant community working on sites; there is no need to speak English. The situation has changed since 1 May 2004 for migrants from A8, as all undeclared workers from these countries have now the right to work in the UK. Although they must register with Work Permits, they do not have to do so if they are self-employed.

Undeclared labour is associated by all respondents and in the literature mainly with renovation, repair and maintenance in the domestic sector for private house owners. A number of reasons explain this. The domestic repair and maintenance market is easy to enter; there are often lower skills and educational requirements, little need for capital investment, no need to contact Government officials; and payment for work can easily be done 'cash-in-hand'. The market is also characterised by high-value products and services, making it an attractive target for tax fraud. Furthermore, given the large number of small and medium-sized companies, which almost entirely dominate the market, control and enforcement of regulations are difficult to apply. The work is of casual nature and can easily be done as 'moonlighting'; skills are transferable and flexible arrangements can be made between the client and the company/worker.

The sector includes a large variety of activities, such as home extension and conversion work, central heating and insulation, kitchen and bathroom fitting, door and window work, electrical and decorative work. With the exception of the CC respondent, all interviewees considered that repair and maintenance is done mostly by the local workforce; however, the number of migrants doing such work may be on the increase. The main customers are private households, willing to pay a cheaper bill by avoiding VAT and paying cash-in-hand.

The most common trades and professions mentioned by our respondents in relation to undeclared work are those associated with house building. Bricklayers, specialist carpenters, and roofers are all to be found refurbishing domestic property or undertaking commercial work for occupiers who are also owners. Undeclared work is likely to occur among the so-called 'walking trades', those where workers carry their tools around with them (building workers). Some nationalities are also associated with certain trades, such as Polish electricians and plumbers.

There is a common perception about the existence of 'moonlighting' (that is, irregular work alongside a regular employment), which is believed to occur mainly in the domestic sector. It is facilitated by the widespread practice of employers allowing workers, depending on market conditions, to take home tools and vans during the weekends, when undeclared work can be done.

## Reasons

Problems of finding experienced, skilled workers with specific trade skills are widely reported in the industry. Shortages in the UK construction sector have increased significantly over the 1990s and into the 21st century. They are especially severe in house building. Shortages range across the skill spectrum, from the highly skilled (engineers, architects), through middle-range trade skills (electricians, plumbers, carpenters, bricklayers) to the low skilled, and are closely related to problems of

training. Indeed, currently there is little development of lifetime skills in the industry and no clear career path and structure. Skills development is possible only if there is proper regulation and direct employment, but solutions tend to focus not on employment regulation and a comprehensive industry-wide training scheme but on importing the necessary skilled labour. The pressure to opt for cheaper labour does not encourage investment in skills development.

The problem of skills shortages appears also to have another explanation. FMB and our CC respondent see one of the main reasons for the skills shortages that a large proportion of the construction workforce operates in the informal economy for greater profit margins. Furthermore, the assumption that undeclared work is done mainly by low skilled and low-paid workers is not confirmed for the British construction industry; indeed, our respondents suggested that skilled workers, especially in trades in high demand, are to be found in the black economy next to semi-skilled or unskilled workers. As our UCATT interviewee put it, “the more skilled are the workers, the greater is the chance that they engage in undeclared work”.

The requirement to pay standard-rated VAT on domestic RMI work is also believed to give unregistered companies a distinct competitive advantage over registered companies. The former obtain RMI work at lower prices by evading VAT, and thus put pressure on legitimate companies to engage in informal activity.

There is a real and immediate financial gain for people in evading tax or National Insurance Contributions both in terms of take-home earnings and in helping at the same time to ensure that they are not priced out of the labour market by cheaper competitors. Significantly, employers and employees share an interest in avoiding wage-related taxes and social security contributions, employers being under competitive pressure to keep their wage costs low and employees seeking to avoid deductions from gross wages.

## Dynamics

The growth of illegal and undeclared working is fuelled by economic growth and business practices such as subcontracting, as well as an increased supply of labour willing to work 'off the books' or unable to choose to do otherwise. This is certainly the case in the UK where, despite a steady growth in construction activity, there has been an erosion of the employment relationship with the rise in self-employment in absolute figures over the last 3-4 years. Those engaged in undeclared activities just want work and cash-in-hand; for all the actors involved, it is a question of profits and savings and the extent of such activities – considered to have increased in recent years – will depend on how interested the client is and how rigorous the control of the contractor/ subcontractor.

## Effects

The unfair competitive advantage of companies that use informal labour was referred to by our respondents, as well as in the literature. There seems to be a widespread understanding of the negative impact of regulatory compliance on the ability of

companies to compete in a cost-driven market. Companies operating informally create pressure on law-abiding competitors to move away from regulatory compliance. There is an increase in casual employment, sporadic self-employment and informal employment supported by social security fraud as a result of the competition-driven informalisation of formal businesses. Furthermore, Lord Grabiner argues that the fact that a significant proportion of the population is routinely engaged in illegal activities encourages a more casual attitude towards the law.

The existence of the informal economy also has important broader social costs, namely a loss of revenue for the state in terms of non-payment of Income Tax, National Insurance and VAT; a loss of regulatory control over the quality of jobs and services provided in the economy; exploitation of individuals and specific groups.

Undeclared work raises health and safety concerns among actors in the industry. While larger official companies are believed to respect safety standards, smaller companies and those operating in the domestic sector have worse accidents record because it is a question of cost.

It is widely recognized in the industry that undeclared work has a significant impact not only on the social protection of the individual, but also on social provision in the society. For the individual engaging in undeclared work, it means immediate financial gain but a loss of rights to benefits, sick pay and state pension, and no access to an occupational pension scheme; hence the reduction in the social wage. This is a loss to the individual and a long-term cost to society as undeclared work means a considerable loss of revenue for the social protection of workers as no social charges are deducted. Consequently, there is an indirect increase in social charges for those carrying out undeclared work.

## Measures

In 2004, a number of steps were taken to strengthen the immigration regime: the Immigration (Restrictions on Employment) Order 2004 came into force, which strengthened the system of checks by employers on job applicants' entitlement to work by revising the list of specified documents. The Immigration Service substantially increased its enforcement effort in relation to illegal migrant working, including apprehending more illegal workers and bringing legal action against more employers using illegal migrant labour. There are financial (up to £5,000) and penal (imprisonment up to six months) sanctions for employing foreigners illegally.

The UK Government published its five-year strategy for asylum and immigration on 7 February 2005. There is a new 5-tier scheme in the process of being established whereby employers can apply for foreign workers and they can settle in the UK. A special advisory board will assess shortages by sector and region. However, our respondent from the UCATT considered this to be a very bureaucratic approach, one difficult to enforce and perhaps having the effect of increasing undeclared work.

In the UK, a number of groups are reviewing the informal economy. These include:

- *the Informal Economy Working Group*, chaired by Customs & Excise and attended

- by Inland Revenue, the Department of Work and Pensions and the Home Office;
- *the Cross-Cutting Policy Team* in the Inland Revenue, primarily investigating the informal economy from the perspective of tax-compliance;
- *the Illegal Working Stakeholder Group*, chaired by the Home office Minister of State for Citizenship, Immigration and Nationality and attended by the Parliamentary Under Secretary of State for Employment Relations, Competition and Consumers in the Department for Trade and Industry and considering issues around illegal labour and practical ways of tackling these.

Enforcement of regulations is shared between the immigration authorities, the customs and taxation authorities, and the police. A range of 'joint shadow economy teams' have been set up within government, as well as the tripartite Illegal Labour Steering Group. The government plans to set up a combined 'frontier force' of police, customs and immigration officers.

## Good practices

A number of promising initiatives may have a positive impact on reducing undeclared work in construction, but they are yet to be implemented and tested. For instance, CSCS cards are regarded as likely to have an impact on the shadow economy. However, the CSCS scheme has no statutory powers and there is no legislation in place to reinforce it. Another promising initiative is TrustMark, in which all social partners, the Government and the trade associations are involved. TrustMark is a new scheme designed to protect consumers from cowboy builders. By choosing a TrustMark tradesperson, consumers know that they will get a high level of service as all trade associations and their members have met the scheme's core standards.

In order to avoid the stigmatisation of illegal workers, British trade unions have launched initiatives to unionise categories of workers who are likely to work undeclared, such as self-employed or migrant workers.



## Working method

In order to provide the necessary information and findings direct methods (survey, interviews) were used, combined with figures and data available from international and national statistical institutes and research centres. Starting point of the research was an assessment of the existing basic studies and initiatives in order to take stock of the outcome of these studies and to evaluate the overall effect of implemented and applied policies in this area. Affiliates from the European social partners and CLR-experts provided important information during the whole process.

The work of the national experts was split up in three main activities:

- an analysis of available national facts and figures; an assessment of existing national reports,
- the work with a questionnaire for the quantitative part of the national report,
- a qualitative part based on interviews with spokesmen and key persons in the industry and inside the services of the main actors in this field.

A qualitative report cannot be the result of desktop research alone and besides that national experiences (of social partners in construction, paritarian funds, policy makers, labour inspectors and other authorities) can be an important and valuable source of information. In order to tackle the wide variety of the shapes of undeclared labour national experts had the freedom to use different sources, different methods (survey, interview, statistical analysis, cases) in a common frame of reference for this project. Basic parameters defined in the preparatory research were used as guidelines for further national examination and were grouped in a non-exhaustive list of items:

### a. Items related to the national regulatory system relevant for construction

- Applicable legislation (taxation, social security, labour legislation).
- Licences and other building regulations.
- Liability regulations (fiscal, social contributions, labour conditions).
- Industry wide agreements or provisions (paritarian or tripartite).
- Collective agreements at different levels (generally binding).
- Other types of relevant social protection.

### b. Items related to the authorities or institutions involved

- Tax authorities.
- Social and labour inspectorate.
- Social benefit institutions.
- Labour organisations, sectoral institutions.
- Courts, juridical institutions.
- Local government.

c. Items related to the nature and features of undeclared work in construction

- Extent and different forms; sector specifics; dynamic.
- Relationship with specific sub sectors; market segments.
- Any relation with economic cycle (boom – recession).
- Main customers or clients.
- Relation formal and informal market; significance of regulation.
- Share of the underground production in construction output.
- Relation with skills, trades or professions, pay level and target groups.
- Regional differences.

d. Items related to the functioning of the undeclared construction market

- How is the market organised.
- Recruitment, offer and demand.
- Hiring in, hiring out, the role of agencies.
- Local networks, offering in public spaces and through advertisements.
- Hierarchy, ‘rules and regulation’.
- Contradictions.

e. Items related to the effects of undeclared work in construction

- Distortion of competition, socio-economic effects.
- Fiscal revenues.
- Pressure on social provisions and benefits.
- Undermining of industry wide provisions.
- Public perception; industry’s acceptance.

f. Items related to measures taken

- Categories of measures.
- Authorities or institutions involved.
- Target group.
- Implementation by whom.
- Monitoring, compliance, control.
- Enforcement, sanctioning.
- Effects and assessment.

g. Items related to good practices

- Partners or initiators.
- Target group.
- Implementation by whom.
- Monitoring, compliance, control.
- Enforcement, sanctioning.
- Evaluation of effects; transferability.

## Funding/commissioning of the project

Within the European Social Dialogue of the Construction Industry, the EFBWW and FIEC decided in 2005 to consider the issue of undeclared labour as one of the priorities. In order to facilitate and stimulate sectoral employment issues the European social partners of the construction industry created a separate working group “employment” within the European social dialogue of the construction industry. Both social partners have stressed the importance of the item in their joint multi annual working programme and have agreed that a sectoral assessment and discussion to prevent and combat undeclared labour in their sector is important and required.

The EFBWW and FIEC proposed the European Commission to finance sectoral research in this field. The actions of the project were formulated in line with the general objectives of the budget heading 04.03.03.01 “*industrial relations and social dialogue*”. The primary objective was to strengthen and stimulate the discussions within the working group “employment”. The aim was further to provide important and useful information to the Council, the European parliament, the Commission and other stakeholders on the issue of transforming undeclared labour into regular employment. EFBWW took the lead for the program management and commissioned the research to the CLR-network.

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Tables

Table 1: Undeclared labour. Overview of findings in earlier research – New Member States and candidate countries

Country	Number of workers involved	Share of construction labour population	Share of construction output	Main form
Bulgaria	up to 80 % of the workforce is, one way or the other, involved	40 %	20-25 %	<ul style="list-style-type: none"> <li>- no employment contract</li> <li>- evasion of social security contributions</li> <li>- declaration of wages lower than received</li> <li>- 'bogus' self-employed</li> </ul>
Cyprus			2 %	<ul style="list-style-type: none"> <li>- underreporting of income</li> <li>- undercoverage</li> </ul>
Czech Republic	(300,000 all industries)	(7 % overall workforce)	20 %	<ul style="list-style-type: none"> <li>- unregulated labour relations</li> <li>- 'bogus' self-employed</li> </ul>
Estonia		10-15 %		<ul style="list-style-type: none"> <li>- envelope wages</li> <li>- subcontracting into the 'grey'</li> <li>- minimum wage plus cash-in-hand</li> </ul>
Hungary	200,000 workers			<ul style="list-style-type: none"> <li>- subcontracting into the 'grey'</li> <li>- non-registered employment</li> <li>- minimum wage plus cash-in-hand</li> <li>- illegal foreign workers</li> </ul>
Latvia		over 23 %	(15-18 % overall GDP; higher in construction)	<ul style="list-style-type: none"> <li>- underreporting of income</li> <li>- legal and illegal jobs combined</li> <li>- minimum wage plus cash-in-hand</li> </ul>
Lithuania			25 %	<ul style="list-style-type: none"> <li>- minimum wage plus cash-in-hand</li> </ul>
Malta	1,000 workers	10 %		<ul style="list-style-type: none"> <li>- seasonal work</li> </ul>
Poland	(estimate of illegal migrant workers: 150,000)	30 %		<ul style="list-style-type: none"> <li>- legal and illegal jobs combined</li> <li>- illegal foreign workers</li> </ul>
Romania		25-40 %		<ul style="list-style-type: none"> <li>- mainly in repair and maintenance</li> </ul>
Slovakia		17 %	below 10 %	<ul style="list-style-type: none"> <li>- mainly in repair and maintenance</li> <li>- cash-in hand</li> <li>- no invoices submitted</li> </ul>
Slovenia			5 %	<ul style="list-style-type: none"> <li>- moonlighting</li> <li>- no invoices for smaller building work</li> </ul>
Turkey		(22 % overall workforce)		

Table 2: Undeclared labour. Overview of findings in earlier research – Old Member States

Country	Number of workers involved	Share of construction labour population	Share of construction output	Main form
Austria	(construction stands for 39 % of the total hidden economy)			<ul style="list-style-type: none"> <li>- non-registered employment</li> <li>- VAT and tax evasion/fraud</li> <li>- bogus self employed</li> </ul>
Belgium				<ul style="list-style-type: none"> <li>- social fraud</li> <li>- VAT and tax evasion/fraud</li> </ul>
Denmark			25% of hours worked	<ul style="list-style-type: none"> <li>- irregular jobs next to regular ones</li> <li>- VAT and tax evasion/fraud</li> <li>- 'bogus' self-employed</li> </ul>
Finland	17,000-23,000 person-years		9-16% (1998); 11 % (2005)	<ul style="list-style-type: none"> <li>- irregular jobs next to regular ones</li> <li>- VAT and tax evasion/fraud</li> <li>- illegal foreign workers</li> </ul>
France				<ul style="list-style-type: none"> <li>- undeclared employees and activities</li> <li>- VAT and tax evasion/fraud</li> <li>- illegal foreign workers</li> </ul>
Germany		19.3 % of the legal working hours	140 billion Euro (2004)	<ul style="list-style-type: none"> <li>- irregular jobs next to regular ones</li> <li>- 'bogus' self-employed</li> <li>- underreporting of income</li> </ul>
Greece				<ul style="list-style-type: none"> <li>- non-registered employment</li> <li>- VAT and tax evasion/fraud</li> <li>- evasion of social security contributions</li> <li>- 'bogus' self-employed</li> <li>- illegal foreign workers</li> </ul>
Ireland				<ul style="list-style-type: none"> <li>- VAT and tax evasion/fraud</li> <li>- evasion of social security contributions</li> </ul>
Italy		23.6-26.9% (2000)		<ul style="list-style-type: none"> <li>- VAT and tax evasion/fraud</li> <li>- evasion of social security contributions</li> <li>- minimum wage plus cash-in-hand</li> <li>- irregular jobs next to regular ones</li> <li>- 'bogus' self-employed</li> <li>- illegal foreign workers</li> </ul>

The Netherlands				<ul style="list-style-type: none"><li>- irregular jobs next to regular ones</li><li>- social benefit fraud</li><li>- 'bogus' self-employed</li><li>- 'bogus' temporary agencies</li><li>- illegal foreign workers</li></ul>
Norway				<ul style="list-style-type: none"><li>- VAT and tax evasion/fraud</li><li>- irregular jobs next to regular ones</li><li>- organised fake business</li></ul>
Spain				<ul style="list-style-type: none"><li>- VAT and tax evasion/fraud</li><li>- subcontracting into the 'grey'</li><li>- irregular jobs next to regular ones</li><li>- illegal foreign workers</li></ul>
Sweden				<ul style="list-style-type: none"><li>- irregular jobs next to regular ones</li><li>- VAT and tax evasion/fraud</li><li>- illegal foreign workers</li></ul>
United Kingdom				<ul style="list-style-type: none"><li>- 'bogus' self-employed</li><li>- irregular jobs next to regular ones</li><li>- social benefit fraud</li></ul>

Sources table 1 and 2: *EU Enlargement, Construction Labour Relations as a Pilot*, The Hague, 2003. *Monograph on the situation of social partners in new Member States and Candidate Countries*, Isabelle Vandenbussche (ed.), Université Catholique de Louvain, 2004. News, The Rockwool Foundation Research Unit, 2003, 2005. *Brief overview of the industrial relations aspects of undeclared work*, EIRO country reports, Dublin, 2004.



# Shifting Employment: undeclared labour in construction

This study is the result of preparatory European research and national investigations on 'undeclared labour' in 10 European Union Member States. The main objective of the research is to analyse the variety of forms subsumed under 'undeclared labour' in the construction industry, to assess current measures to prevent and combat undeclared labour, and to make recommendations on the basis of best practices. In all countries the shares of undeclared labour output and employment appear to be much higher in construction than their averages in the gross domestic product and overall employment. From the evidence of the reports the authors conclude that:

- the highest incidence of undeclared labour relates to work carried out by workers in addition to their regular job;
- the status of self-employment is abused, with bogus practices by national citizens as well as foreign 'independent' workers entering the market through labour-only subcontracting;
- dubious agencies and labour traffickers supplying cheap illegal labour mainly from abroad have returned. "Illegals never complain and work hard" and only little "persuasion" is needed because of their illegal status.

This publication includes desktop research, a summary of the findings with conclusions, and the experts' 10 country reports.

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